STEP 6

Sign Lease / Purchase Property

Lease Tips

The U.S. Small Business Administration (SBA) has the following tips for entering a lease:

▶ SETTING THE TERM (LENGTH) OF YOUR LEASE

The term and rent that you will pay is your first negotiation point. The key here is not to over-commit while giving yourself some flexibility for the long term. It's generally recommended that small businesses negotiate one to two year leases with the option to renew should you wish to. You'll also want to factor in and negotiate rent increases over the term and renewal options so that you are not unexpectedly hit with a rent increase without warning from your landlord – something that can quickly compromise your cash flow and margins.

Remember to be prepared for pushback. A landlord is much more likely to favor locking you in for the long-term if they can by "sweetening" the deal. It's a good idea to have a broker involved who knows the local market and what tricks and "sweeteners" the landlords are likely to offer. Remember the broker works for the landlord and gets commission on the total lease value. It's worth talking to a real estate lawyer before consulting a broker; they can often recommend the right choice for you and work consultatively with you as you negotiate your lease through the broker.

▶ WHAT ABOUT EXPENSES?

As with residential leases, commercial real estate landlords often tag on extras such as maintenance fees, upkeep for shared facilities (Common Area Maintenance or CAM), and so on. What about utilities? These charges are usually the responsibility of the tenant, but how are they measured? Are they individually metered or apportioned by the square footage? Ask to see these "hidden fees" and policies as well as examples of costs that are typically incurred by tenants.

▶ WHO HANDLES MAINTENANCE AND REPAIR?

While residential leasing often places the burden of maintenance and upkeep on the shoulders of the landlord, commercial leases are different. Just because the landlord owns the building, it would make sense to believe that they are responsible for repairs and upkeep – this is not always the case. Commercial leases vary in their approach to this. Some stipulate that the tenant is responsible for all property upkeep and repairs while others specify that the tenant is responsible for systems such as the air conditioning, plumbing, etc.

Check your lease. – in addition to stating who is responsible for what it may also contain dollar limits on how much the tenant must pay for maintenance and repair. An attorney can help clarify your legal options.

Glossary

Base Rent: A set amount used as a minimum rent in a lease with provisions for increasing the rent over the term of the lease.

Build-out: The space improvements put in place per the tenant's specifications. Takes into consideration the amount of Tenant Finish Allowance provided for in the lease agreement

Certificate of Occupancy: A document presented by the City Building Department certifying that a building has been satisfactorily inspected and is in a condition suitable for occupancy.

Common Area Maintenance (CAM): This is the amount of additional rent charged to the tenant, in addition to the base rent, to maintain the common areas of the property shared by the tenants and from which all tenants benefit (e.g., snow removal, outdoor lighting, parking lot sweeping, insurance, property taxes).

Concessions: Cash or cash equivalents expended by the landlord in the form of rental abatement, additional tenant finish allowance, moving expenses, cabling expenses or other monies expended to influence or persuade the tenant to sign a lease.

Default: The general failure to perform a legal or contractual duty or to discharge an obligation when due. Some specific examples are:

1) Failure to make a payment of rent when due.
2) The breach or failure to perform any of the terms of a lease agreement.

Effective Rent: The actual rental rate to be achieved by the landlord after deducting the value of concessions from the base rental rate paid by a tenant, usually expressed as an average rate over the term of the lease.

Gross Lease: A lease in which the tenant pays a flat sum for rent out of which the landlord must pay all expenses such as taxes, insurance, maintenance, utilities, etc.

Net Lease: A lease in which there is a provision for the tenant to pay, in addition to rent, certain costs associated with the operation of the property. These costs may include property taxes, insurance, repairs, utilities, and maintenance. There are also "NN" (double net) and "NNN" (triple net) leases. The difference between the three is the degree to which the tenant is responsible for operating costs. See also "Gross Lease".

Percentage Lease: Refers to a provision of the lease calling for the landlord to be paid a percentage of the tenant's gross sales as a component of rent. There is usually a base rent amount to which "percentage" rent is then added. This type of clause is most often found in retail leases.

Triple Net (NNN) Rent: A lease in which the tenant pays, in addition to rent, certain costs associated with a leased property, which may include property taxes, insurance premiums, repairs, utilities, and maintenances. There are also "Net Leases" and "NN" (double net) leases, depending upon the degree to which the tenant is responsible for operating costs. See also "Gross Lease".

READ THE LEASE

Read over your lease in detail and hire an attorney who specializes in commercial real estate to review the clauses and fine print.

CONSIDER BUILDING IN CLAUSES TO PROTECT YOUR BUSINESS

To protect your investment and long term business interests, it's worth investigating and negotiating some potential add-on clauses to your lease. These might include:

- **Sublease** – This builds in some flexibility so that should your business plans change you can sublet your space to another business.
- **Exclusivity clause** – Prevents the landlord from leasing any other premises on the development to a direct competitor of yours.
- **Co-tenancy** – If the development has an anchor tenant such as a known retail brand and that tenant closes, a co-tenancy agreement can protect you from a potential loss of custom by allowing you to break the lease if the landlord doesn't replace the anchor tenant in a specified time period.

WHAT IF YOU DEFAULT?

Businesses often close down without prior notice because they defaulted on their lease. Protect your interests and your customers by knowing what you are agreeing to upfront. Will you be locked out immediately? Will the landlord initiate eviction proceedings? Can you negotiate more time for yourself should you default? If you default could you pay only the month's rent owed as opposed to the remaining money owed on the lease? It's worth investigating.

Other Considerations

BUSINESS INSURANCE

Like home insurance, business insurance protects your business against fire, theft and other losses. Contact your insurance agent or broker. It is prudent for any business to purchase a number of basic types of insurance. Some types of coverage are required by law, others simply make good business sense. The types of insurance listed below are among the most commonly used and are a starting point for evaluating the insurance needs of your business.

- Liability Insurance – Businesses may incur various forms of liability in conducting their normal activities. One of the most common types is product liability, which may be incurred when a customer suffers harm from using the product. There are many other types of liability, which are frequently related to specific industries. Liability law is constantly changing. An analysis of your liability insurance needs by a competent professional is vital in determining an adequate and appropriate level of protection for your business.
- Property – There are many different types of property insurance and levels of coverage available. It is important to determine the property insurance you need to ensure the continuation of your business and the level of insurance you need to replace or rebuild. You must also understand the terms of the insurance, including any limitations or waivers of coverage.
- Business Interruption – While property insurance may pay enough to replace damaged or destroyed equipment or buildings, how will you pay costs such as taxes, utilities and other continuing expenses during the period between when the damage occurs and when the property is replaced? Business Interruption (or business income)

insurance can provide sufficient funds to pay your fixed expenses during a period of time when your business is not operational.

- Key Man – If you (and / or any other individual) are so critical to the operation of your business that it cannot continue in the event of your illness or death, you should consider “key man” insurance. This type of policy is frequently required by banks or government loan programs. It also can be used to provide continuity of operations during a period of ownership transition caused by the death, incapacitation or absence due to a Title 10 military activation of an owner or other “key” employee.
- Automobile – Any vehicle owned by your business should be insured for both liability and replacement purposes. What is less obvious is that you may need special insurance (called “non-owned automobile coverage”) if you use your personal vehicle on company business. This policy covers the business’ liability for any damage which may result from such usage.
- Officer and Director – Under most state laws, officers and directors of a corporation may become personally liable for their actions on behalf of the company. This type of policy covers this liability.
- Home Office – If you are establishing an office in your home, it is a good idea to contact your homeowners’ insurance company to update your policy to include coverage for office equipment. This coverage is not automatically included in a standard homeowner’s policy

▶ TAXES

Taxes are an important and complex aspect of owning and operating a successful business. Your accountant, payroll person, or tax adviser may be very knowledgeable, but there are still many facets of tax law that you should know. The Internal Revenue Service is a great source for tax information. Small Business/Self-Employed Tax Center: irs.gov

When you are running a business, you don’t need to be a tax expert. However, you do need to know some tax basics. The IRS Small Business/ Self-Employed Tax Center gives you the information you need to stay tax compliant so your business can thrive.

▶ CITY REAL ESTATE TAX

Most businesses have a lease that uses the NNN (triple net) approach. In this approach, your business is responsible for the portion of property taxes of the space you occupy. It is a good idea to get an understanding of what this cost will be prior to signing a lease.

▶ CITY BUSINESS PERSONAL PROPERTY DECLARATION

All Connecticut business owners that own personal property must file a “Personal Property Tax Declaration” report annually with the City Assessor. This report has to be filed by November 1st and failure to do so or filing late will result in a penalty equal to 25% of the assessed value of the property (per State law).

In the report, the businesses are required to declare most of the personal property used by the business. Real property (real estate) is not declared on this form. Communities assess the value of real estate and bills taxpayers accordingly. Similarly, registered vehicles are also not declared on this form. The Connecticut Department of Motor Vehicles (DMV) tracks these and notifies towns regarding the amounts owed.

▶ CITY MOTOR VEHICLE TAXES

Any vehicles used by the business are subject to City Motor Vehicle Taxes.

PERSONAL PROPERTY DECLARATION

In general, personal property is anything that is moveable and is not a permanent part of real estate, including items such as business-owned furniture, fixtures, machinery or equipment.

All commercial businesses that have tangible business assets located in Norwich are required by law to submit a declaration of their personal property assets to the Assessor each year by November 1.

A 25% assessment penalty is applied if the form is not submitted by the November 1 due date.

If you have a question regarding the personal property declaration form, or how an asset should be categorized please contact the City Assessor | 860.823.3723.