

India Weekly USA, August 20, 2006

THE LAW & YOU

COMMERCIAL PROPERTY – LOCATION AND LEASING

By: Bijal M. Jani, Esq.



One of the many characteristics that the South Asian community is known for is its eagerness to engage in business entrepreneurship. As such, many clients wish to operate and manage a business. But, there are certain factors that should be considered before embarking on the establishment of a business. While investment funds, working capital, and experience are important, two of the most critical factors include the physical location of the business and the decision to purchase or lease the business premises.

While there are no set rules for determining the location of a business enterprise, the business owner should note the following when making the decision: which type of location is best for the kind of business intended; is the location of the business critical to the profitability of the business; is the location suitable for the business intended; and how much funding can be allocated towards the purchase or leasing of the premises? Answers to these queries assist the business owner in determining the best plan of action for the location of a business.

Although location is crucial for most businesses that cater to the public, certain types of businesses are not really affected by their physical location. Therefore, businesses engaged in retail sales of products such as cigarettes, newspapers, food items, and consumer goods must be careful to choose locations that offer greatest public accessibility, while businesses that do all their work “on-site” may not have to maintain high-cost/high-visibility premises. When making the determination about location, factors to consider in advance include ease of access to pedestrian customers, parking for driver customers, and general safety of the customers.

Choosing the location of a business also depends on the amount of capital funding that should be utilized for the purchase or lease of the premises. Although each business has its own distinct circumstances, there are significant differences in the decision to purchase or rent the premises out of which a business is to be operated. The decision to purchase the business premises offers benefits such as overall long-term financial savings, security in knowing that the business will not have to be relocated at the end of the lease term, substantial control over the maintenance/renovations of the premises, appreciation in land value, and tax savings. The decision to lease the premises allows for increased cash flow, the landlord maintains responsibility for the premises, the business owner is unaffected by decreasing property values, allows ease of relocation if the need arises, and the lease payments may be deducted as a business expense. Summarily, the chief advantage of purchasing the premises is that less capital is expended in the long-run and the real estate may appreciate in the future. The primary advantage of leasing commercial space to operate a business is that the initial capital expenditure is less than required in a purchase.

If it is determined that the best mode of action for the location of the business enterprise is in a leased premises, than the issues involving commercial leases come into play. At the outset, it should be noted that commercial leases are very different from residential leases and ignorance of these differences is generally what causes business owners to make bad leasing decisions. First, commercial leases are not subject to most consumer protection laws that cover residential leases. Therefore, certain laws that protect residential tenants do not apply to commercial tenants. Second, most commercial leases utilized are not the standard simplistic forms that are sold at office supply stores. Generally, landlords retain the services of attorneys who prepare extensive lease agreements that may contain detailed clauses which may be unfavorable to the tenants. Third, since business owners must have premises that conform to their specific business needs, commercial leases tend to be subject to more negotiation than residential leases. Fourth, commercial leases are legally binding contracts with large security deposits and guarantees attached, making the possible "breaking" of the leases very difficult and expensive.

Prior to signing and entering into a commercial lease, it is critical that prospective tenants seek the advice of an experienced attorney to avoid considerable issues and/or monetary losses later. An attorney familiar with commercial leases can help avoid many of the usual pitfalls that business owners face when entering into long-term commercial leases. Some of the items addressed are the length of the lease, including renewals and terminations; rents and escalations; payments for insurance, property taxes, and maintenance; security deposit and its restoration to tenant; exact location and/or square footage of the occupied space and common areas; construction, improvements and modifications and who pays for what; maintenance of the premises; assignments and sub-leases; mediation and/or litigation; and personal guarantees.

Experience in commercial leases indicates that although many landlords maintain an attitude with prospective tenants that the terms of a lease are not negotiable ("take it or leave it"), a competent attorney can negotiate favorably on behalf of a prospective tenant. Although the local market conditions may affect the degree to which a landlord may negotiate the terms of a lease such as rental amounts and improvements to the premises, most commercial leases should be modified to meet the needs of the particular tenants. For example, if a high-visibility location of the premises is the priority for a business owner, then he/she should be prepared to pay a higher lease payment and may want to consider a longer lease term to protect its long-term stay in a favorable location. However, if a business is a start-up and the profitability is questionable, it is better for the tenant to negotiate a short-term lease with options to renew.

If a business owner determines that the purchase of real estate property is more advantageous for the operation of a business, the advice of an attorney should be sought to assist in resolving issues such as clear title ownership, environmental concerns (especially with gas stations and laundromats), and zoning restrictions. Since many of these aspects may affect the overall operation and management of a business in the long-run, any questionable issues should be resolved prior to purchase of the property to avoid immense needless expenditures later.