

The Top 10 Pitfalls to Avoid with Your Dental Lease



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The lease for your dental practice may be the most expensive contract you will ever sign in your career as a dentist professional.

These agreements are typically carefully crafted by property owners and their attorneys to maximize the value of the property and to give the owner the maximum amount of control over your premises, which could eventually put you and your practice in jeopardy.

Unfortunately, some dentists make the mistake of signing leases without fully understanding how the details within the agreement will affect their practice in the future.

Commercial lease transactions can be very complicated and require a great deal of attention. There are several essential concepts that you need to understand and important things that you need to do when negotiating any lease, and just as many mistakes (potentially more) that you need to avoid.

Here is a list of the top 10 pitfalls to avoid when negotiating a lease for a dental office or during the renegotiation process at the end of your lease:

1. The Right to Assign or Sublet

The right to assign or sublet is often overlooked when negotiating a lease. However, it can have a dramatic impact on your situation later in the lease. This issue arises when your practice is experiencing significant change (either growth or contraction) and needs to make changes in its real estate strategy.

Having these rights will increase your flexibility and reduce your risk. First, you need to understand two very similar concepts:

- Sublet; and
- Assignment.

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When you *sublet* the premises, you rent to someone else, you (the tenant) retain primary liability for the lease payments. You are the *sublessor* and are directly responsible for default by the *sublessee*. You collect rent from the sublessee and continue paying your rent to the landlord, regardless of what payments you do or don't receive from the sublessee.

When you *assign* your lease to someone else, you are simply the guarantor of the lease, while the new tenant has primary responsibility. The new tenant deals directly with the landlord, while you have been effectively removed from the process. However, because you are the guarantor of the lease, if the new tenant defaults on the lease terms, you will have to step in and make the landlord whole.

The right to assign or sublet might seem unimportant when you are negotiating your lease, but it has the potential to become extremely important later on, especially if and when you want to sell your practice.

When you sell a practice, you typically need to assign the lease to the buyer. However, if your assignment can be denied by the landlord, this can impede the sale of your practice.

The way to avoid this potential pitfall is to make sure your attorney has included the proper language in your lease that will prevent the landlord from denying an assignment and thereby blocking the sale of your practice.

All lease assignments and sublets require landlord approval but in most cases an assignment or sublease cannot be unreasonably withheld. Make sure your lease requires that the landlord have a substantive reason for withholding an assignment or sublease.

The common phrasing is the landlord has the right to approve a sublease or assignment but cannot deny it unreasonably. An attorney who specializes in commercial leases and is familiar with the local market can give you a better explanation of what is typically considered reasonable or unreasonable.

2. Remove Tenant Improvements

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Tenant improvements (TIs) are the physical improvements made to the space, also known as the *build-out*. A TI allowance is a negotiated amount of money paid by the landlord to the tenant in exchange for signing the lease, to be used for building out the space to suit the tenant's needs.

Negotiating a tenant improvement allowance can be a significant part of a lease. For a large-scale lease, it can often be more than the value of a full year's rent. In general, a larger TI allowance will improve the quality of the space and reduce your capital expenditure.

There are numerous mistakes tenants may make when negotiating an improvement allowance. Perhaps the biggest mistake is failing to ask for a cash allowance. (Receiving the allowance up front, rather than reimbursement after improvements are made.) Cash allowance (upfront) will eliminate the need for you to front the cost yourself and then wait to be reimbursed by the landlord.

A TI can be defined very broadly but is generally considered to be the actual build-out of the rental space. When you are negotiating the lease however, you should also include the many related expenses, such as architectural work, project management, space planning, and moving costs, for example. The broader definition means you will then have more flexibility in how you can utilize your negotiated TI allowance.

You should also ensure that while you are negotiating a TI allowance, you also ensure the deletion of any TI removal provision from the lease. This type of provision pertains to the tenant's obligation to restore the space back to its original state at the end of the lease term. Negotiating the removal of this clause from the lease will typically save you \$5 - \$10 per square foot.

3. ADA Improvements

The Americans with Disabilities Act (ADA) is a federal law that prohibits discrimination against individuals with disabilities and guarantees them accessibility in all areas of public life, including jobs, transportation, schools, and all public and private places, even websites.

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Buildings and spaces must be built or modified to comply with both state and federal accessibility regulations under the ADA.

ADA compliance is enforced through lawsuits. Failure to comply with ADA regulations can result in your practice being sued and ordered to pay substantial monetary penalties.

It can be very costly to bring a rental space into compliance with the ADA. Therefore, if the space you are leasing requires a build-out, the TI allowance should include the cost of ADA improvements, such as:

- Wheelchair lifts;
- Wheelchair ramps;
- Elevators;
- ADA-compliant bathrooms;
- Minimum corridor widths and door clearances;
- Accessible treatment rooms and examination chairs;
- Etc.

Both you and the landlord are responsible for assuring that the space you lease for your dental practice is accessible to individuals with disabilities and the details should be worked out in your lease. Here are a couple of suggested negotiation points:

1. Suggest that an ADA survey be done as part of the due diligence process. This will allow you to use any lack of accessibility to your advantage during the negotiation phase of the transaction. Then, if you decide to lease, you can request that the owner have an implementation plan in place to remedy any compliance issues quickly before you take over the property.
2. Ask the landlord to warrant that:
 1. Both the building and the rental space are in compliance with ADA regulations, based on an inspection performed by a qualified professional; and
 2. That any improvements that he or she will be making will comply with all the necessary accessibility standards.

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4. Taxes

Although the tax provision in a commercial lease generally requires very little negotiation, said negotiation may be extremely important. This is because every detail can have a significant impact on your practice's financial outlook.

As a tenant, you can't properly assess the cost of a commercial lease without first understanding your tax liabilities under that lease. Nevertheless, the tax implications of the terms of a lease are often overlooked by both the tenant and the landlord.

The "Taxes" provision of your lease agreement will usually define what will be considered a tax (e.g. property tax, income tax, etc.) and describe which taxes you will be required to pay.

How taxes are defined and described in your lease will partly determine whether you will be operating under a gross lease structure or triple net lease structure.

In a gross lease structure, the tax provision is usually divided into two sections - one which describes what taxes for which the landlord is responsible, and another which specifies what "*separate taxes*" (the tenant's personal property taxes) will be the financial responsibility of the tenant.

In a net lease structure, the tax provision is typically written so that the tenant is responsible for all taxes, with a few exceptions. These exceptions will typically be described as any "*taxes levied on the net income of the landlord,*" but should also include any franchise taxes, estate taxes, inheritance taxes, net income taxes, gift taxes, corporate taxes, and excess profit taxes.

It is always in your best interest to negotiate as many tax exceptions as possible, and you should be sure to consider any details in the lease's tax provision pertaining to issues like:

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- What taxes will be you will be required to pay;
- How these taxes will be paid and who will be responsible for ensuring that they are paid;
- Who has the right to dispute a tax assessment and who will be required to pay for it;
- What, if any, “special taxes” you may be required to pay and how they can be mitigated.

Finally, it is important for you to properly assess whether, after adding up the base rent and operating expenses, minus any tenant improvement allowance and free rent, you will still be able to afford the space if tax rates increase.

5. Option to Renew

An option to renew gives a tenant the legal right to extend the terms of the lease or expand the lease at their sole discretion. The language describing the right to renew typically stipulates both how long the lease can be extended and at what rate.

The lease rate will often be set at *Fair Market Value (FMV)*, which can be defined as the rate or price the property would fetch on the open market, under fair market conditions—reasonably knowledgeable buyers and sellers, behaving in their own best interest, free of undue influence, and with a reasonable amount of time to complete the transaction.

There are specific methods used for determining FMV. But, in order to ensure that FMV can be legally enforced, you must work with a commercial real estate attorney to make sure that these mechanisms are included in your lease using the correct language.

You should always attempt to negotiate an option to renew with a specified lease rate. This way, if market rental rates increase, the option will guarantee a below-market rate.

Should market rates decrease, you can simply refuse the option and negotiate a new lease. In this way, an option to renew increases your flexibility because you can use it when it's good for you, or refrain from its use when it would be disadvantageous.

6. Exclusivity Clause

Leasing space for your dental office can quickly become complex, especially when you are under pressure to negotiate the best value for your money. Competition is also an important component to consider when negotiating your lease or purchase agreement.

You never want to be one of many dental practices in the same complex. This is why you should consider negotiating an exclusivity clause into your lease.

When properly drafted, an exclusivity clause restricts your landlord from leasing space within the same building or complex to competing tenants with the same business purposes. This is particularly important if you are in a very competitive market.

Having too many of the same types of businesses in the same complex is not a great environment for anyone. Furthermore, it does both the tenants and the landlord a disservice.

A properly worded exclusivity clause will protect your practice from competition within the same building or complex. It can also promote a diversity of tenants which, in return, may increase your customer base and profits.

7. Relocation Clause

A relocation clause gives the landlord the ability to move a tenant to another space that is reasonably equivalent in size and layout as the original space, typically on the same floor and in the same building. The purpose of the relocation clause is to balance the landlord's right to control over his or her own building with the tenant's right to have quiet enjoyment of the rental space.

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On one hand, a relocation clause gives the landlord much-needed flexibility and control over the rental space. On the other hand, it can be extremely inconvenient for the tenant, who may be required to move to another rental space in the middle of the lease term. It can also be very costly for whoever ends up paying for the relocation.

Here are a few things to consider when reviewing, drafting, and negotiating the relocation clause in your lease:

Where does the landlord have a right to relocate you? (In the same building? On the same floor? Any space the landlord has available? To another building?)

- How much notice must the landlord provide? A 30 or 60-day notice period will probably not be enough time to do all that needs to be done. 100-120 days might be more appropriate.
- What are the standards for the new space? For example, will it be of similar size and layout as the current space? Will the views be the same? What about the quality of the finishing, fixtures, and furniture? Will certain types of decorations, such as wall paintings, be transferred?
- What happens if the new space is a different size? Does the rent get adjusted? Do you have a right to measure that space?
- Who will pay the cost of relocating and bringing the new space up to the standards of the old space? These costs should always be borne by the landlord, but what about soft costs for things like new stationery, advertising material, logos, and other things that may be affected by the address change?
- How many times can you be made to relocate? Do you have the right to terminate the lease if the relocation is not acceptable to you?

8. Recapture Clause

Generally speaking, a recapture clause allows a landlord to take the space back upon certain conditions. One such condition that might allow a recapture clause to be invoked is if you attempt to sell or transfer your practice to someone else.

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Most commercial leases give the landlord the right to approve or disapprove a sublease or assignment. The right of recapture coupled with the right of approval means that the landlord not only has the opportunity to deny the sublease or assignment through the approval process, but they can also access the right of recapture to terminate the lease and then lease the space directly to the prospective new tenant.

You should therefore consider negotiating some constraints around the right of recapture that will narrow down when the landlord may exercise that right. In the best scenario, you will be able to negotiate any recapture clause completely out of the lease. When that's not possible, you should try to negotiate multiple options to deny any requests for recapture.

9. Hazardous Substances

Environmental issues, particularly those involving hazardous substances have become real estate issues. Most landlords understand these issues and will ask you for assurances that you will not add any environmental problems to their property.

What if the property you are about to lease has been contaminated by a previous tenant? What if the landlord doesn't know it is contaminated? What kind of liability might you have as a new tenant in that space? Does your lease contain any kind of environmental assurances from the landlord?

To protect yourself and your practice from potential liability for environmental problems associated with the complex and/or the particular space you are leasing within the complex, you should request warranties, representations, and indemnities from the landlord that they are free and clear of any issues involving hazardous substances.

You should also ensure that any indemnification you are required to give is as narrow as possible and does not require you to be responsible for any pre-existing conditions or issues involving hazardous substances that were caused by others or previous tenants.

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Here, it may benefit you to work with an experienced commercial real estate professional to ensure you have the right language in your lease agreement. Although a real estate professional should not be expected to have the technical expertise necessary to determine that a building or rental space is or isn't free of any hazardous substance problems, they should be familiar with state and federal environmental laws and the regulatory agencies that enforce them.

10. Heating, Ventilation, and Air Conditioning (HVAC)

When it comes to negotiating a commercial lease, HVAC issues are often a sticking point. This is because maintaining, repairing, and replacing an HVAC system (when necessary) can be very expensive and can be extremely disruptive to the tenant's business operations.

In the typical commercial lease, the tenant is usually responsible for all the costs related to maintenance, repairs, and replacement of the HVAC. But this is not always fair because the tenant may be paying to maintain or replace a system that is already old or has been damaged by previous tenants.

If the system is new, it should be under warranty and the lease provision pertaining to the HVAC should contain language that ensures the warranty will pass through to you. If the system is not new, you should be allowed to inspect it to determine what state it is in and to estimate how long before you will need to replace it.

If you are still concerned or unsure about the condition of the HVAC, you should consider negotiating with the landlord to obtain some type of warranty and/or cap on the costs to repair or replace the system when necessary.

Conclusion

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There are certain pitfalls that all business owners encounter repeatedly when negotiating the lease or purchase of commercial real estate—tenant improvements, the Americans with Disabilities Act, taxes, renewal options, exclusivity, tenant relocation, property recapture, hazardous substances, and HVAC issues. An experienced attorney can help you avoid these potential pitfalls before you sign your lease.

Commercial lease transactions in California can be complicated and very costly if not handled properly. Negotiating a commercial lease without the help of an attorney can result in the forfeiture of ten to hundreds of thousands of dollars in profits.

You can either hire a qualified attorney to assist you with negotiating a commercial lease to give yourself a leg up in the game, or you can invest hours and hours of your own valuable time, only to end up with a lease that puts you and the future of your practice in jeopardy.

To ensure that you get the most when negotiating the lease or purchase of your dental office space, contact an attorney who specializes in representing dentists and medical professionals in California. Call Ali Oromchian at **Dental & Medical Counsel** at **925-999-8200**, or send us a message [via our contact form](#) to receive more information.



Have questions regarding your lease?

Dental & Medical Counsel was built with doctors in mind. We understand that you already have a busy professional life full of stress, heavy workload, and constant liability. Let us help you reduce your stress levels, improve your work/life balance, and reduce your worries and concerns with legal matters.

Additionally, our comprehensive and unique approach enables the most entrepreneurial dentists, veterinarians, optometrists and physicians to achieve their personal and business goals as they create massive wealth through smart strategies with the peace of mind of knowing that their practices are compliant with all federal and state laws.

Regards,

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