

SENSIBLE SOLUTIONS

SUCCESSFULLY NEGOTIATING A REAL ESTATE LEASE

A real estate lease is a long legal document designed to protect the landlord. Although landlords are often reluctant to revise a pre-printed lease form, they will consider an addendum or rider to the lease. In order to negotiate an appropriate lease it is important to ask the proper questions. This can be done even before you ask your corporate attorney to review the lease.

Before you begin negotiations with a landlord, certain due diligence should be performed. Find out from other tenants if the landlord manages his facilities well. Is the landlord's financial status solid? How long has the landlord owned the building and does he intend to keep it? Check court records to see if there are any lawsuits against the landlord. Most likely you will be investing considerable money in your space and it is essential that you are investing in a stable environment.

Determine whether the lease is "gross" or "net." In a "gross" lease the landlord pays the real estate taxes, utilities, insurance, and maintains the building. A "net" lease transfers

specific financial obligations from the landlord to the tenant. Thus you may be responsible, in addition to the monthly rent, for real estate taxes, insurance, utilities, maintenance, and other designated expenses. In addition, retail leases often provide for "percentage rent," i.e., additional rent based upon your sales revenue.

If the space is going to be modified, will the landlord perform and pay for work, or give you an allowance and expect you to arrange for the construction and pay for it? Include a provision that your trade fixtures do not become part of the landlord's property and can be removed upon termination of the lease. Make certain to determine if there are any restrictions in the lease that may preclude you from an intended use. You should also make sure that local zoning ordinances do not preclude you from using the property as you intend.

At the conclusion of the lease term is there an option to renew? Are there any options for additional space? Is there an established rental rate for the renewal period or a maximum amount the rent may be increased?

Retail locations are not always successful regardless of the best laid plans. For this reason, retail leases often contain a "kick-out" provision allowing the tenant to terminate the lease upon notice and the payment of rent during the notice period. If the landlord will not agree to a "kick-out,"

you will have to sublease the premises or assign the lease to a third party. Unlike a "kick-out," this will typically require the landlord's consent and you will still be liable under the lease if the sub-tenant or assignee does not perform its obligations.

In addition, some leases contain a "recapture" provision, in which the landlord can terminate the lease and recapture the premises if you request its consent to an assignment or sub-lease. This can be disastrous if you are selling your business, and your location is a key element of your goodwill.

Like any negotiation, preparation is the key. If you have used a real estate agent, he or she may be a valuable resource during the negotiation process. A bad lease could be the difference between profit and loss. A good lease can be a valuable asset that contributes to success. Ask the proper questions in order to negotiate appropriate terms, and your efforts will pay off.

SOME FUNDAMENTAL THINGS YOU NEED TO KNOW ABOUT SELLING YOUR BUSINESS

For many business owners, the sale of their business is often the consummation of a life's work. In

order to maximize the value of your business, and minimize your stress, here are the basics which you need to know.

Selling Stock or Selling Assets. There are two common ways to structure the sale of a business. The first is to sell assets. The second is to sell stock.

From the buyer's point of view, purchasing the assets of a business is often preferable. In an asset transaction, the buyer can acquire only those assets which it wants to own. Moreover, by purchasing assets, the buyer gets a stepped-up tax basis in those assets equal to the purchase price allocated to them. This allows the buyer to take increased deductions on its tax returns for depreciation and amortization. Finally, by purchasing assets, a buyer can usually avoid acquiring unknown or unwanted liabilities.

From the seller's point of view, the chief drawback to an asset sale is that it can result in additional tax liability at the corporate level that would not exist in a stock sale. This will occur only if the seller is a "C corporation," because "C corps." are taxed at the corporate level. However, if the seller is an "S corporation," or a partnership or limited liability company, the gain realized by the seller on the sale of assets passes through to the owners, rather than being taxed at the entity level.

Therefore, if the seller is a "C corp.," its owners will prefer a stock sale. There are, however, several drawbacks to buying stock rather than the underlying business assets. First, the buyer cannot obtain the benefit of increased depreciation and amortization deductions because stock cannot be depreciated or amortized. Second, a transfer of stock always results in the buyer acquiring all of the seller's liabilities. Thus, despite the best due diligence, the buyer always runs the risk of assuming unknown

liabilities, such as unpaid tax obligations, product liability claims, or even a lawsuit by a disgruntled employee. A buyer's only protection from the risk of unexpected liabilities is to seek indemnification from the seller. This is nothing more than a promise that the seller will pay for any undisclosed liabilities that surface after the sale.

Covenants Not to Compete. Every seller should expect to give the buyer a covenant not to compete (sometimes referred to as a restrictive covenant). The purpose of a covenant not to compete is to protect the goodwill being acquired by the buyer by preventing the former owners from competing against their old company. Although covenants not to compete are sometimes difficult to enforce, particularly in the employment context, such covenants signed in conjunction with the purchase and sale of a business are routinely upheld by the courts.

Unfortunately, the tax treatment of these covenants is not very favorable to the buyer or the seller. Any amount paid to a selling individual in exchange for his/her covenant not to compete is ordinary income rather than capital gain. From the buyer's standpoint, the buyer cannot deduct such payments on its tax returns, but must amortize them over 15 years (even though the covenant not to compete will always have a much shorter life).

Due Diligence. "Due diligence" is the term used to refer to the investigative process associated with the purchase and sale of a business. Due diligence is the way the buyer makes sure it is getting what it pays for. Oftentimes, sellers find the due diligence process to be quite burdensome. Sellers will often spend weeks digging materials out of files for the buyer to review, and otherwise making its offices, staff and records available to the buyer. For the well

organized seller, the process should not be too painful. For less sophisticated sellers, the due diligence process often involves getting the company's records into the shape they should have been in the first place.

The prudent seller will begin the due diligence process before it even has a buyer. This involves getting each aspect of the business in order by gathering up copies of corporate records, financial statements, tax returns, insurance policies, contracts, leases, loan documents, and the like; preparing lists of customers, vendors, furniture, fixtures, and equipment; and assembling any other information pertinent to the business. The seller's goal should be to minimize any surprises. No business is perfect, and often the best way to deal with a problem is to disclose it sooner rather than later. We have seen deals almost fall apart at the end because of something discovered by a buyer at the last minute that would have posed little problem if disclosed early on.

Some Final Tips. Buying or selling a business can be a stressful event. It is definitely not something that business owners should attempt without some help. The key to making any transaction a success on both sides of the table is to involve skilled legal and financial advisors early in the process. Finally, buying and selling a business takes time. Don't expect to have it done in a week or two. The typical transaction usually takes anywhere from two to six months from beginning to end. Somewhere along the way you will almost certainly lose some sleep, but with some preparation and planning, you can minimize the stress and maximize the price and tax advantages.