Tim Dudley:

Likely, you have one of two situations. Just high level, you are either interested or have leased property for your business, or you are interested or have purchased or sold property. So that comes from a 30,000 foot or higher level. Those are probably your two main experiences with real estate, either leasing, or buying or selling.

Jeff Large:

That's Tim Dudley, real estate attorney with Rhoades McKee. And as you probably guessed it, today on Conversations with a Business Attorney, we are discussing leasing and buying real estate. I'm your host and fellow business owner, Jeff Large.

Now Tim and I explore a few things. The pros and cons of leasing versus buying a property, the process of acquiring a property and what to expect, and the things that you can do to make the buying and/or selling process easier for yourself and all parties involved. Our conversation begins with Tim explaining the variables for deciding whether to lease or to buy a property for your business.

Tim Dudley:

Yeah, well there are a number of factors you might consider, and one of them is just market in your financial position, and whether you can afford to purchase real property. Whether there's an opportunity to purchase real property, and if there's any inventory that makes sense for your type of business.

Another might be the long-term strategy for your business, whether it makes sense to invest in real estate or it makes more sense to lease the property and see how things go before you make that major investment in real estate purchase. So you might want to test the waters a little bit with a shorter term lease, and see if your business is young, and you're just starting out maybe with a couple options to extend if things go well. You could incorporate an option to purchase potentially if the landlord is agreeable to that too, if you want to maybe have that option to get that property wrapped up in your name.

Jeff Large:

So I'm hearing my own financial state, the long-term plans. Do you see in the work that you're doing from a practical standpoint, or from some of the examples that come top of mind, is one typically favored more than the other in terms of owning versus leasing or is it just-

Tim Dudley:

No, it really depends on the situation. Owning the property might offer a little bit more stability long-term, right? Your lease rate is not going to increase. Your taxes might, but theoretically, you get that back when you ultimately sell it. So that might offer a little bit more stability, but there's also more of initial outlay as far as your expenses go when you're starting out to purchase your property, is typically not cheap as we all know.

Jeff Large:

I'm assuming more of the expenditures would come from just the responsibility of owning the location, opposed to similar payouts in terms of monthly fees with, if I'm going to do a lease versus if I'm going to own it. But it's like all of that additional responsibility that comes along with it is where that more heavier burden lies.

Tim Dudley:

Yeah. And it kind of depends on your lease too. Some leases are what's called triple net, or an absolute triple net situation where the tenant for all intents and purposes acts as the owner, pays the taxes, pays the insurance, does the maintenance. So those in that situation, the lease situation is the same or similar to owning property, you just don't own it. And at the end of the lease, you can walk away.

But it might be different. If it's more of a shorter term lease, it might be where you don't have those obligations. Your only obligation is to pay the rent and maintain the interior of the leased space rather than pay the taxes, pay the insurance, and maintain some of the more structural items that the landlord typically is responsible for doing.

Jeff Large:

Let's go down that road a little bit further. Let's say I am in a position that I've decided leasing is my better option. And again, as we sort of stand at the beginning of this a little more broadly, what are the factors that I consider? What do I need to be thinking about? What factors do I need to be aware of walking into a lease?

Tim Dudley:

The most obvious one is the rent. How much am I going to pay per month per year? But that's the main one that every tenant considers initially, can I afford to be here. Can I afford this space?

That's an obvious one, but others are term, how long do I want to be here? Is this a five-year situation? Do I want a longer-term lease so that I have contractual rights to stay at this space for 10 years or longer? And you can play with that a little bit with lease options to extend, renew, in which case a five-year term might be able to turn into a 10 or a 15-year term by exercising options to extend that lease.

Jeff Large:

Is it the idea there to keep it in the same payment? Is it more of a matter of trying to keep consistency with your costs? Is it more of a matter of getting the guarantee that you'll be able to be in the same location for your customers? What are those factors?

Tim Dudley:

Probably more of the latter, just to guarantee that you can stay in the same space. And move is pretty disruptive and costly, and can really be a critical problem for your business. If like you said, customers are used to you being in one place. Even if you don't have customer traffic, it's still a burden to move business locations, and there's no guarantee that another space is going to be as good or better than the one you have currently. So you want to lock up that space potentially as long as you can. And with lease options, that gives you a good way for the tenant to get out if it's not working, but have the option to stay if it is.

It could be that you want to lock in your rate as well, but typically there's some sort of escalator throughout the term. And more likely than not, when you exercise that option to extend, there's going to be some sort of escalation, whether it's a percentage or maybe a reevaluation of what market rent is, or CPI increase, or something like that. But there's typically going to be some sort of rent increase, but it might be lower than what the market rate is if you've got that extension rate too.

So it could be a little bit of combination of both, but probably the primary factor is locking it in so you don't have to move if you've been successful after five years or 10.

Jeff Large:

Yeah. That wouldn't be very fun if all of a sudden you just had to leave.

Tim Dudley:

Right. And we've had clients that have that situation where they're established in a location, and they don't want to leave, and the landlord may have some other plans for the property after the lease term expires. And there's not much you can do if the landlord's set on having you out if you don't have those renewal or extension terms.

Jeff Large:

Yeah, no, that's important. What are some other potential concerns that I should be looking out for or paying attention to when we talk about these different lease agreements?

Tim Dudley:

Often the maintenance and repair provisions are highly negotiated and scrutinized, and a tenant and a landlord will want to make sure that those provisions are consistent with their expectations for who's going to care for and maintain the leased space or maybe even the surrounding property. It depends on what the lease space is. The lease space might be the entire tax parcel. So it includes the building, entire building, parking lot, driveway, landscape space, the entire property. Or it might include just a suite inside a building, and then you'll have rights in common with others to use.

So in a situation where you've got a tenant who is leasing the entire building and surrounding property, the tenant may be responsible for maintaining, replacing, repairing everything on that parcel, including the building, the driveway, the parking lot, the landscaping.

Jeff Large:

Let me jump in. These are things that I didn't even think of yet, because I've been working remote for the last six years. And so I just automatically assume, I just get the physical space that I'm in, like the suite, like you said. I didn't really think about leasing it from the parking lot and all the rest of it. What would be the advantage of leasing also the property and the rest of it? Why would I want to do that?

Tim Dudley:

In that case, you would be leasing the entire building. You just need the entire building. So your business requirements require the entire space, or the building is just a one space. It might have a manufacturing facility inside, and you're leasing that building. There's no other space for other tenants or other uses, so you're leasing that building, and you're leasing the property because you want control of the entire thing. Essentially yours. It's a situation where for all intents and purposes are the owner of it. You just don't own the title to the property.

Jeff Large:

Remind me why I wouldn't want to do that. If I'm owning everything, or if I'm kind of "owning everything" and I'm responsible for everything, why wouldn't I want to own it again?

Tim Dudley:

You may not be able to afford it. You may not have other options out there. There might not be a similar facility for sale that works for you. Those are more business decisions, and you might just want to be able to have that flexibility where I'm going to walk away after five years or 10 years potentially. And if it's not working out, I can do that. If I own real property, first I've had to invest in it and then I've got to sell it. There's risk to owning real estate also.

If you have that situation where you lease the entire property, you might have the obligation to repair, replace, maintain everything, and have those costs. And theoretically, you're going to pay less if you're taking care of all those other expenses because the landlord doesn't have that overhead.

Jeff Large:

At this point of the conversation with Tim, I was reminded why it's important to be working with an attorney on matters like this on real estate. As a business owner, you're limited in your scope. You're likely making your decision based on one set of factors. But on the other hand, it's Tim's actual job to focus in on making sure that his clients and their interests are protected.

Tim Dudley:

I care about making sure that the client's expectations are reflected in the lease, and that that lease is a fair lease for the client. Those are the two main things that I'm looking at.

Oftentimes, we'll have a letter of intent that can guide us as far as what the parties have maybe already agreed upon, that either a broker or just the client and the other party have negotiated amongst themselves. And so we've got that to guide us as far as what the expectations are from the client's perspective.

And then where we come in is we can guide them as far as what's customary, what's reasonable, where are your exposures to costs you haven't anticipated, or liabilities that you might not be aware of? Things like that is where we come in and add some value, and just make sure that that lease does in fact represent what the client's expectations are, and is fair and reasonable.

Jeff Large:

Yeah, it's such a common theme in these conversations for me of just mitigating risk, making sure that you're actually getting what you think you're getting. That's what having a solid attorney helps you safeguard those basics. Some basic questions like, when would be a good time to get an attorney involved in this process? So I'm starting it. I'm going through it. When should I bring my attorney in?

Tim Dudley:

Yeah, probably as you've heard in other scenarios as well and talking to other people as soon as possible, that we want to be involved as soon as we can. Not necessarily that we need to be heavily involved from the beginning.

And often we're not. Like I said, sometimes we'll get a already signed letter of intent that we haven't had any involvement in yet. But when that happens, we can often... And it comes to pass where we're bringing up things in that letter of intent like, "Well, help me explain this. Did you think about this?" Or sometimes wish we hadn't have already agreed to this, and if we get it on the front end, it's a little bit easier for us to avoid some of those problems.

Jeff Large:

Yeah. I mean, how hard is it to backpedal once you've had an assigned letter of intent?

Tim Dudley:

It depends. Sometimes you can, I don't want to say ignore terms. We try to make it consistent with the letter of intent so that there's no blowback when it goes to the other side and say, "This is not consistent with the letter of intent." But if it's something that is important, letters of intent are typically non-binding agreements anyway, so there's some wiggle room to adjust or pivot if something is that much of a problem. But it's not ideal. If we're in on the front end, the beginning, then we can maybe avoid some of those situations at first.

But it's not critical. I mean it's not uncommon at all for us to receive a signed LOI and say, "Hey, I need a lease," and that's not typically the end of the world by any means. But the sooner we can get together just to maybe review a letter of intent that's being considered for signature is a good time to get your attorney involved.

We don't need to negotiate necessarily the letter of intent. We can do that sometimes, but a lot of those business terms may be better handled by a broker. But being able to review that letter of intent before it gets signed can be helpful.

Jeff Large:

Okay. And then also, say for this situation specifically when I'm negotiating a lease, what qualities should I look for in an attorney? Maybe I don't have one yet and I'm looking for one. What kind of qualities or experience should I expect them to have?

Tim Dudley:

Yeah, you should expect your attorney to have experience negotiating, and drafting, and preparing leases. Your attorney should be, I think a reasonable person.

Jeff Large:

You mean I don't want an unreasonable attorney?

Tim Dudley:

Well, yeah. An unreasonable attorney makes things more difficult for everybody and costly. The more difficult it is to reach that end result of a mutually agreeable lease, and just drives up cost and time for everybody. Those are the two, experience, and I'll just call it reasonableness, are I think the two most important things.

And someone that you work well with too, that you can understand, that understands your business, and needs, and is listening to you. And understanding what you have in mind, rather than someone that's just going to throw out a document that's off the shelf and doesn't care about your specific needs.

Jeff Large:

Another aspect you should be considering, what are the options and challenges that you have if you want to get out of your lease before the end of your term?

Tim Dudley:

That's an important... Both on the front end, the right to assign or sublease is often a negotiated term where the tenant wants the right to freely assign it to whoever they want if they want to step out of the space and get a new tenant in there. They want the right to hand that off, assign that lease to another tenant. Or sublease it, which would be, I'm stepping out of a portion of the space. I'm going to keep half of it, and someone else is coming in and take half of it. They're going to pay half the rent. We're talking about those situations, and the tenant wants the right to freely do that. And the landlord doesn't want the tenant to have that right to freely assign or sublease. They want control of who is going to be in that space, understandably so. They own the property. They want to make sure that the tenant that's coming in is a tenant who has the assets to be able to pay the rent and maintain the property, has a good reputation.

Maybe they've dealt with the tenant before in another location and have had bad experiences, and they don't want to deal with them again. They want some control of who's going to be leasing that space, other than letting the tenant make those decisions for it.

So you often compromise with a provision where the landlord can't unreasonably withhold its consent, or there are certain criteria that the replacement tenant has to satisfy in order to get that landlord's consent. The tenant that's coming in, the new tenant will want to make sure the conditions are satisfied or met before they assume the lease. They want to make sure that the existing tenant's paid all its rent up to date. They want to make sure that the landlord's not aware of any defaults, that the property is in good condition, things like that. Just make sure that when they're stepping into that lease, they're stepping into a clean situation where they're ready to hit the ground running, and there aren't any hidden issues that they've got to resolve. Because once they step into that lease, they become the tenant.

That new tenant is going to get some indemnification from the existing tenant for items that have happened before the assignment of the lease, so that if there's rent that's unpaid, new tenant's not going to step in and be responsible for that rent that the previous tenant was responsible for. Or if they didn't maintain something that they were required to maintain, then I'm not going to become responsible for that. Although I might be responsible to the landlord, the old tenant's going to reimburse me for those costs. The important thing to note is that you want to make sure that you get some representations from the landlord when you're coming into that situation, that new lease.

Jeff Large:

Some common themes that I just continuously hear, it goes back to some of those adages of we do business with people. You think about these companies that we frequent, but at the same time it's often the people that are involved. Or when you get services involved or whatever, it's who you're dealing with. And this feels like very much one of those situations, even to your comment prior to, you don't want somebody that's difficult whether it's the attorney. But I could also see it being an issue, just because you have very different desires, and it's a tension that you have to run between. And if you don't walk into the situation understanding that it should be fair for both parties, of maybe you've got to give a little here and they're going to give a little there, that seems really big.

It still kind of comes down to A, is the situation fair for both parties? And then B, like you said, did you miss any details? Are you represented well? And so obviously, I can see that having somebody that knew what they were talking about more than I did walking into an agreement like this would be beneficial for me, just because there are nuances like that. If you haven't had experience working in this space or working and purchasing, leasing, and whatnot that you very easily could overlook.

Tim Dudley:

Sure, yeah, absolutely. And by fair, doesn't always happen, right? I mean it also can depend on leverage. As a landlord, you might have a national chain that's coming in, Walmart, or Amazon, or something like that, that can come in and dictate the terms. In which case you're going to have to reset your expectations of, I'm probably not going to get everything I want here, but I'm going to get a great tenant in here I know is going to be able to pay the rent, and has the resources to take care of the property, and I'm not going to have to worry about it. So I might give a little bit on some of these other terms that they're not going to budge on anyway. Or the landlord might have the leverage in other situations, where the tenant's not going to get everything that they want to. So there's a give and take, depending on the specific leverage that either party has.

Jeff Large:

Valid points. So let's transition a little bit, and talking about strictly leasing. But what about in transactional style relationships, whether we're buyer or seller? Why don't you set the stage for me there?

Tim Dudley:

Yeah. So often, we will get involved when a business is purchased or sold, in which case there almost always is a real estate component to that. Whether that's the seller owning real estate that the buyer's going to purchase as part of the business transaction, or the seller owns real estate that the buyer's going to lease, and there may be the third category there would be that the seller leases space from a third party that the buyer is going to assume that lease. We kind of talked about assumption of a lease or assignment of lease just a moment ago, but that would be a situation where you might have an assignment.

So those are the three situations where we might get involved from a real estate perspective in a business transaction. Well, let's start with seller.

Jeff Large:

Okay, what do I need to know about seller? What are big aspects that I should be-

Tim Dudley:

Yeah, the seller's maybe a little bit easier. If you're selling the real estate, you are going to want to make sure that you're getting... Again, it's like rent is your primary concern. Are you getting the amount that you want for the property? That's really the seller's main concern there. You're also looking at, typically a purchase agreement for real estate will include some representations and warranties as far as the condition of the property or the state of the selling party. I'm going to take a look at those closely, so that you're not representing or warranting things that you shouldn't, or can't, or that are unreasonable for seller to represent, especially when the buyer can have a chance to do its own due diligence and figure out, kick the tire so to speak, so they can see what's wrong with the property, and make sure that it's in the condition that they want. So those are a couple things that you want to look at from a seller perspective, or consider when you're selling the real estate.

Jeff Large:

If I may interject, I find myself as you're talking, just looking for more things that I can relate to, because I haven't personally gone through this yet. How does this differ from say just buying and selling a home? What things would be unique to the business side of it?

Tim Dudley:

So buying and selling a home is typically a quicker process. You're concerned about price primarily. And you will most likely get what's called a title commitment, which is essentially, what are the documents that affect the title to the property? Easements, restrictions, making sure that the party that's shown as the seller on the purchase agreement is in fact the owner of the property.

So typically, you might have an inspection that's done by an inspector, might get an appraisal. You've got to secure your financing typically, but it's a pretty quick process.

Jeff Large:

I mean, on most accounts it's pretty straightforward. What in addition then am I factoring in as a seller from the business standpoint?

Tim Dudley:

From a seller's perspective, when I expect it's going to take more time. It's not going to be a couple of weeks or a week to close in most situations. The buyer's going to need time to inspect the building, to review title work and all the documents that affect title. They'll want a chance to object specifically to some of those items that are objectionable, that don't satisfy, or they're not satisfied with.

Jeff Large:

Is there just more liability involved?

Tim Dudley:

Well, in certain circumstances, yes. And one of the things that the buyers should want to do is an environmental site assessment, and so there is more liability there. And that's one thing that drives the length of a due diligence or inspection period in a commercial transaction that doesn't typically happen in a residential transaction. You're not doing a phase one environmental site assessment in the residential transaction. But in a business setting, if the buyer purchases, closes on the property, they will automatically become liable for whatever contamination exists. If they don't do that environmental due diligence to phase one environmental site assessment, phase two if necessary, and what's called a baseline environmental assessment if necessary as well. And that all takes time, typically. And we've done them within two weeks, but that's really pushing it.

Jeff Large:

What about just generically speaking? Like we said, if closing on a home is several weeks to a month-ish, something like that, what is the standard timeframe that I'm looking at for a business transaction?

Tim Dudley:

Minimum of 45 days.

Jeff Large:

That sounds like it's hustling based on what you're describing.

Tim Dudley:

That's hustling typically, but 60 to 90 is a more customary due diligence period. And it can go up to 120, 180 days, or longer, and it depends on the nature of the transaction. But you're looking at months, and not days or weeks in most situations, because it takes time. You need to get a survey typically in order to make sure the property is as you believe it to be. Identify the location of easements. Maybe it identifies encroachments onto or off of the property, maybe able to identify errors in the legal description, things like that.

So the commercial buyers and sellers are typically just more sophisticated in understanding the nature of the transaction than residential buyers and sellers. It's not always the case, but typically it is.

And these properties are often more complicated than a house. You've got a house, a driveway, a lawn, everything's kind of the same in every house. Whereas in these commercial or industrial properties, you never know what you're going to get.

Each building is a different use. So it might be an industrial facility that has some significant environmental contamination involved with it, or it might be a commercial condominium in a shopping center, where you've got a bunch of restrictions that are applicable to the property that you're purchasing. Or it might be a marina on the lake, and you've got to make sure that the seller's got permitting and everything that's necessary to operate the marina.

So there's more that goes into it than just, do I like the house, does it have curb appeal, and does it just pass my pretty simple inspection? There's a lot of other things that you've got to consider.

Jeff Large:

Do you have any fun stories of surprises that you or your clients have encountered?

Tim Dudley:

Yeah, so there was one situation where we represented the buyer of a warehousing and industrial facility that had an existing tenant. We were interested in purchasing the building for some warehousing of our own, and the particular product that we were interested in warehousing was pickles. And client entered into an agreement with the seller so that they could store those pickles before closing. So it was a short-term license agreement. And the other tenant complained about the pickle smell that was emanating from the storage of the pickles. And so we had to address that issue.

Jeff Large:

You had to take legal action over a pickle smell?

Tim Dudley:

Yeah. I mean, we resolved it quickly, and swiftly, and amicably. That was not something that, certainly I expected to have to deal with pickles, when I signed up for that one.

Jeff Large:

That's too funny.

Tim Dudley:

So yeah, you never know what you might come across.

Jeff Large:

So we were talking a lot from the seller side, and I feel like you can kind of start to piece together what you need to consider on the buyer side. But is there anything specific on that end that maybe alters or is different from the seller side that we need to be paying attention to?

Tim Dudley:

The buyer, we talked a little bit about this already, is really that due diligence that they need to conduct. And that's title, review a title commitment, and the documents that are shown as exceptions on that title commitment. The survey, get your environmental work with a good consultant. And inspect the building. Make sure it's in a condition that you want it to be in. That's the primary difference between the buyer and the seller. The buyer wants the time to kick the tires and make sure everything is in the condition that they want it to be in. From title survey, environmental is kind of three main due diligence items. And the seller just wants to close and get its money as quickly as possible. So you've got a little bit of friction there, as far as how long you're going to have to do those due diligence items. But those are all important things that a buyer really needs to do, or they might end up with some surprises after closing that they have to deal with., That could be expensive to resolve.

Jeff Large:

Yeah. So I'm hearing from a seller's perspective, it's a matter of making sure that you are presenting what is actually there, presenting the property in an authentic state, in an accurate state. Like you said, it's also important that you can move your transaction as swiftly as possible, just so you're able to cash out on an error as you see fit. And then from the buyer's standpoint, it is a matter of the due diligence to check and see that you're actually getting what you think you're getting, that the terms are the way that they're described. I mean, is that a fair, high level assumption?

Tim Dudley:

Yeah, you described it quite well from a high level. Every transaction is different, so you have some nuances there. And there's other things that you might negotiate, the treatment of the deposit and things like that.

But from an overall transactional point of view, I think you summed it up pretty good. And it is important not just to go through the motions of doing those due diligence items, but to do them well and to understand exactly what your survey's showing you, exactly what the title documents are saying, and making sure your environmental consultant's done a proper phase one, and two, and beyond if necessary.

Jeff Large:

Yeah. So I'm hearing that there's multiple people involved. So who are you typically working with? So it's like I have my attorney, you just mentioned an environmental person. Who's normally involved in these processes, really on either side, on buyer or seller side?

Tim Dudley:

Yeah. Well as the attorney, oftentimes we will be involved in the hiring of the environmental consultant, the surveyor, and a title company that prepares the title commitment, eventually provides the title insurance policy.

So those are the three main other parties that will be involved in the transaction, that the attorney will have heavy correspondence with. You also might have your loan officer if you're financing the purchase. You might have a building inspector and any other consultants that you might want to have take a look at the property, depending on what it is. But that's the three main. So surveyor, title company, and the environmental consultant.

Jeff Large:

Obviously at this point of the conversation, you can hear the many variables that exist when it comes to buying and leasing real estate. So I asked Tim what he wished more clients knew before coming to talk to him.

Tim Dudley:

Well, understanding that timeline is oftentimes something that would be helpful beforehand, just understanding that I can't just close in 10 days, if I'm going to do it properly. That is the one I see most often from purchasers or sellers that really haven't gone through the process frequently. They don't understand that this is a months-long process if you're going to do it right, not a days or weeks-long process.

And sometimes, that becomes a problem when we have a already executed letter of intent. Getting back to that, it's nice for us. That's something that we could catch prior to the letter of intent being signed, is do we have a sufficient enough due diligence period in order to do the work that we need to do?

That's one that we see frequently. And sometimes, we even get a signed purchase agreement that has a 15-day due diligence period, in which case there's not really... I mean, we can try to make that work, but it's not going to get done with the detail that is really necessary.

Every transaction is different, and sometimes that might be enough. And sometimes, the nature of the situation dictates that that's all the time we have. And we have to just make sure that we do as much of a thorough job as we possibly can. But that's one that I see frequently is just understanding the timing of what's involved and how that plays out.

Jeff Large:

Any final advice for people in this seat, that they're approaching leases? I mean, it's obviously a massive topic. We can go into way more detail than we did, but any kind of parting advice of things that you would like our listener to know?

Tim Dudley:

Yeah, I think it's just important to be open to understanding what all is involved in the lease, and understanding that it's going to probably take a couple rounds of back and forth negotiation to get it done. It's not going to be a simple, "Here's your lease. Everyone signs it." There's going to be some back and forth involved. And so it's again, kind of a timing issue. We're just going to take a little bit of time. We can turn it around as quickly as possible, same day sometimes if necessary. But there's going to be some back and forth after that. That's one thing I think that is often not understood, is just the timing and how long it takes to get things done properly.

Jeff Large:

A big thanks to Tim Dudley for sharing his time and his expertise on today's show. If you have any questions around buying, selling, or leasing real estate for you or your business, consider reaching out to Tim or one of his peers. You can learn more at rhoadesmckee.com, and I'll make sure that link is in the show notes.

Conversations with a Business Attorney is a project from Rhoades McKee, and it's produced by Come Alive Creative. Thank you to Rachael Workman, Isadore Nieves, Elaine Moore, and everybody who helped make this episode possible. I've been your host, Jeff Large. And if you found this episode helpful, please make sure to share it with other business owners who might benefit.