

YOUR OFFICE LEASE: IS IT AN ASSET. . .OR LIABILITY?

Congratulations! You have found the perfect location for your veterinary practice. You smile as you envision your operatories filled with clients and their pets as your smiling staff continues to bustle around your office singing your praises. A voice pulls you back from your dream.

“All you need to do is sign here, here, here, and here and this space will be yours!” your future landlord exclaims. As you pull out your pen, time begins to slow down and you begin to notice certain things. First the lease you are about to sign appears to be a book, with words and phrases that seem to be from another language. Second, the landlord’s smile no longer appears to be a smile of warmth but instead now looks sinister, causing your hand to jerk back from the signature line of the lease.

“What’s the matter?” the landlord asks as his voice cracks. It is then that you notice the perspiration surrounding the landlord’s face, as if he is filled with anxiety. “Just sign and it will be yours!”

“I think I should have my attorney look at this before I sign,” you calmly state as you rise from your chair.

Unfortunately, far too many veterinarians believe that once the rent and the length of the lease term have been decided upon, the lease is finished and ready to sign. After all, the lease appears to be a pre-printed form which the landlord says they use with all of their tenants. However, inside the pre-printed lease form lurks unlocked doors which open up to your worst nightmares. Many of the issues inside a lease can significantly impact the value of your brand new office or your recently acquired veterinary practice and your ability to resell it. The lease you are holding in your hand has been perfected over the years by attorneys who represent landlords, becoming one of the most effective weapons a landlord can have. However, in our experience, landlords are generally ready, willing and able to change areas of the lease as long as they feel they are still protected. The following is a small list of some of the areas within a lease which can negatively impact the value of your veterinary practice or restrict you from selling it to another veterinarian.

1. Damage to the Veterinary Practice. The way this section of the lease is written appears to be innocuous. The section appears to be stating the obvious: the landlord has a duty to repair within a reasonable amount of time. However, if you review this section carefully you will see that in most leases there are many “outs” for the landlord so he does not have to rebuild in a timely fashion. Unfortunately, our law firm has seen landlords use this section of the lease to force veterinarians to come back to their old office and start paying rent 2, 3, even 4 years after the building was initially damaged or destroyed! In order to combat the landlord’s “outs” in rebuilding, we suggest asking for time frames for repairs to commence and to be completed, failing which you should have the right to terminate the lease. Generally, our law firm requests 90 days to commence repairs and 180 days to complete repairs.

2. Recapture Provision. Most leases now have a “recapture” provision which allows the landlord to terminate your leasehold interest if you ask for an assignment or a subletting of your office. In other words, when you find a buyer for your veterinary practice you must notify the

landlord that you wish to assign your property interest (known as a leasehold interest) to the buyer of your veterinary practice. At that time, the landlord can either accept the assignment or terminate your lease, leaving you with an established veterinary practice in need of a new home!

3. Personal Options. This section usually makes any option period to extend the lease personal to you, making them useless to any potential buyer. Without at least 7-10 years of a viable lease term (including option periods), many lenders will not want to lend money to buyers to purchase your veterinary practice. How does this impact you specifically?

CASE EXAMPLE: The seller was a very successful doctor who had started his practice from scratch in a growing community. After steadily increasing production figures, the seller wished to move to another state after a decade of running his practice and had already found another practice to purchase. The broker involved in the transaction found a suitable buyer and the lender was willing to fund the entire purchase price of \$1,200,000 ... with one condition. The current lease term only had three years left on the lease but also had two-, five-year options remaining. The lender requested that these be assigned to the buyer. Unfortunately for the seller, the remaining options were personal to the seller.

When the landlord saw how much the seller was receiving from the sale of his practice, the landlord cited the options being personal and argued that he did not have to grant the options to a prospective purchaser and did not want to unless he was paid a very large portion of the purchase price. The seller decried that the landlord was using extortion tactics to extract money from him and threatened to sue him and report the landlord to the authorities. In our review of the lease it was clear: the landlord did not have to grant the assignment of the options. Was this extortion? Absolutely. Was it illegal? No. The landlord was seeking monetary compensation for revising the lease and accepting a new tenant, neither of which he was required to do. After months of negotiation and threats of lawsuits (which our client could probably not be successful in) our client finally concluded that the landlord's position was absolute. He agreed to pay the landlord \$100,000 if the sale went through, simply because he had already moved his family and was close to purchasing his other practice. If the option language would have been negotiated at the time the lease was signed, the landlord could not have asked for a single penny, however this one oversight allowed the landlord to reap a substantial windfall.

4. Transfer Premiums. Many new leases have provisions which allow the landlord to receive a "transfer premium" allowing the landlord to arbitrarily decide the value of the leasehold interest and demand a percentage from you when you sell your practice! Some of these premiums are in excess of 50% of your sale price! Say goodbye to most of the goodwill you have accumulated, it's the landlord's now. While some states have restricted this provision significantly, the vast majority of states still allow this practice to continue. If you limit this section to subletting (the original intent of this section), you can avoid having to pay the transfer premium.

5. Release of Liability. If you are lucky enough to have your lease assigned to your buyer, you will still be "on the hook" for the length of the lease, including any option periods left. This could mean that you have another 10-15 years of personal liability connected with the lease! So much for playing bridge, spoiling the grandkids and taking that vacation to Europe. Try to be removed from future liability after a valid assignment.

6. Subordination Clauses. The subordination clause is an almost invisible clause in most leases because of the intricacies of the mortgage foreclosure laws. These clauses typically require that your lease will become subordinate to any new financing the landlord places on his or her building. If our real estate bubble ever bursts, many landlords will lose their buildings as rents decrease and they can't pay the mortgage. If a lender forecloses and there is a new owner, the new landlord does not have to honor your subordinated lease, and you may lose your veterinary office space. However, most landlords will allow modification to these clauses during lease negotiations because they know they won't own the building if this ever becomes an issue. Therefore, always ask the landlord for a waiver of such clauses.

The above list is a small sampling of the many issues veterinarians face in entering into a lease. When one of the attorneys in our law firm sits down with a veterinarian to explain the many unseen pitfalls in leases, they are astounded, and to be honest they should be. As mentioned earlier, the "form" leases have been in the hands of attorneys for years, constantly being perfected and modified so that their clients, landlords, are protected as well as they can be. While the lease is only one component of owning and operating a veterinary practice, many times it is one of the most important, and the most overlooked. With simple changes to the lease, including the issues mentioned above, the lease can be a valuable asset to you, possibly even increasing the value of your veterinary practice.

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