Don’t Get Bitten: Four Common Pitfalls of Veterinary Practice Leases

Article courtesy of Bank of America Practice Solutions. Written by Daniel Dornfeld, Esq., and Mary E. Mongioi, Esq., Co-Chairs of Veterinary Practice Group, Forchelli Curto et. al LLP

Too often, veterinarians enter into leases without truly understanding the nature of the liability they’re assuming. Here are four key factors you should be aware of before you sign a lease for your practice.

1. Additional rents (pass-throughs)

It’s very important that you understand the full amount you’ll have to pay as rent. That sounds obvious, but if you don’t account for certain expenses, you’ll be surprised when you receive your first bill from your landlord. In addition to your base rent (the amount you’re probably aware of), you’ll probably have to pay additional rents that represent a portion of the landlord’s expenses. To calculate the full cost of your lease, you need to understand the type of lease you’re getting into.

- **Triple net lease.** With this type of lease, you pay your pro-rata share of the landlord’s costs to maintain the property. In other words, you pay the base rent, plus your share of the landlord's operating costs, which can include things such as real estate taxes, insurance, maintenance and repairs. For example, if snow removal costs $1,000 per year and you occupy 10 percent of the building, you’ll pay $100. If you have a triple net lease, then you should know exactly what expenses are built into the landlord’s operating expenses. Before you sign a lease like this, it’s a good idea to get a copy of the historical operating statement for the building which will reveal what those expenses have been in the past. You should also find out whether the landlord has a projected budget for the operating expenses going forward, so you’ll have a reasonable estimate of what your costs will be.
- **Net lease.** With leases of this kind, you typically pay your pro-rata share of the *increase* in the landlord’s operating costs from the time you enter into the lease. Using our previous example, if snow removal costs $1,000 per year and it rises to $1,100, there’s an increase of $100, so you’ll pay $10. If you’re paying the costs of the increase in operating expenses, you should still ask for a historical operating statement. If you assume a 3–5 percent

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increase in the operating expenses, you'll have a good estimate of the increase in your additional rents.

- **Gross lease.** If you're lucky enough to sign this type of lease, you don't pay pass-throughs and don't have to worry about additional rents. Unfortunately, gross leases have become almost nonexistent.

2. Obligations for plumbing, electrical and HVAC systems

Generally, leases will state that the tenant is responsible for maintaining and repairing the systems in their premises, including plumbing, electrical and heating and air conditioning (HVAC) systems. If the equipment is in poor condition, you may end up having to pay for repairs or even replacement. If you're assuming these obligations in your lease, be sure that the systems are in good working condition. If you can't get the landlord to attest that they're in good condition, have the systems inspected yourself, or think twice about getting into the lease. You don't want to move into your new office only to find that you must replace an HVAC unit.

3. Assignment/subletting

It's common for a veterinarian to sell a practice or join a larger practice. In these situations, the lease may need to be assigned to the purchaser or new entity. In some cases, the landlord's lease may prohibit the tenant from assigning the lease. Make sure that the lease provides that you can assign your lease *with the consent of the landlord, which may not be unreasonably withheld, denied or conditioned*. In addition, when the time comes for you to assign the lease, *make sure that your liability terminates when the lease is assigned.* Your lease may state that you're on the hook for the rents if the person you're selling your practice to commits a default—even though you're no longer involved in the space.

4. Size

If you're in a space that's part of a larger building, there's a good chance you're going to pay rent for space in excess of the actual size of your office. The "loss factor" is the percentage of the gross area of a space lost due to walls, elevators, janitorial closets and other common areas. For instance, let's say you lease an office with 2,000 square feet. However, you also have to pay rent for other spaces in the building, which could include common bathrooms, elevators, a mechanical room and a large, ornate lobby. The loss factor is calculated by dividing the common areas included by the total square footage of the building. If the landlord allocates a loss factor of 20 percent for those areas, even though your suite is 2,000 square feet, you'll have to pay rent for 2,500 square feet (i.e. 2,000 divided by 80 percent). When you're looking at possible locations for your practice, be sure to ask if there's a loss factor and what the percentage is. This isn't an issue if you're renting a stand-alone building.

As you're searching for the ideal location for your practice, these are just some of the lease terms that you need to watch out for. Of course, you should hire an experienced real estate attorney who understands the issues you'll be facing. If you have a broker, don't be afraid to ask tough questions. Regardless of which attorney you hire or broker you use, you should understand the terms of your lease clearly, since they may be the difference between a good deal and a bad one.
