

### **What Should Dentists Consider When Negotiating and Reviewing a Lease**

Except for possibly employee salaries, a dental practice's rent expense will most likely be a dentist's largest business expense in any given year. It is, therefore, important that a dentist considering starting his or her own practice be thoughtful about what his or her practice's specific needs are or will be before a lease is signed.

This is true regardless of whether the dentist is purchasing the practice in an acquisition, starting a new "start-up" practice from scratch, or re-negotiating an existing lease. As the old adage goes, an ounce of prevention is worth a pound of cure.

Other than the amount of rent (which is obviously the most important term in any lease), there are many other terms and considerations that a dentist should consider before signing a lease for a new space, renegotiating a new lease, or taking an assignment of an existing lease.

### **Type of Lease**

A dentist needs to be aware of exactly what type of lease is being offered to them. More specifically, a dentist who is comparing multiple leases needs to be aware of the different types of leases the dentist is reviewing so he or she can truly understand what they are comparing. For instance, comparing the base rent amount in one lease to the base rent amount in another may not be an intellectually correct way to assess the leases if each lease is a different type.

A "gross lease" (sometimes called a "full service lease") will cover almost all the expenses associated with the practice space, including base rent, taxes, maintenance, insurance, and janitorial services. Gross leases come with a higher base rent, but are nice in that they provide the leasing dentist with a relatively consistent rent overhead figure that the dentist can use for budgeting purposes. Most landlords are weary of gross leases, however, because they preclude the ability of the landlord to pass on additional unexpected costs associated with the building or premises. A thorough review of a gross lease by an attorney will include making sure that the landlord has not found ways to pass additional or inappropriate costs onto the tenant.

Another common type of lease a dentist will encounter is a "triple net lease" (sometimes abbreviated as a "NNN lease"). Under a NNN lease, the leasing dentist will pay a base rent amount every month for the space in which the practice is operated, which is generally less than what would be paid under a gross lease, plus the percentage share of the common area maintenance costs of the building (i.e., lobby, elevator, parking area, storage area, property management fees, etc.), the property insurance, and the property taxes. The leasing dentist will also be responsible for the utilities associated with the space in which the practice is operated, as well as for the insurance related to the leased space.

NNN leases present the biggest challenge as well as the greatest opportunity for tenant dentists to negotiate.

A dentist with an experienced professional reviewing and negotiating a NNN lease may wish to negotiate caps on the annual amount that costs can increase under the NNN lease, exclusions for certain shared expenses passed down to the tenant as common area maintenance costs (sometimes referred to as CAMs), and find other ways to shift possible costs back to the landlord. Another common area of negotiation in a dental practice's NNN lease is ensuring that the leasing dentist will not have to pay costs associated with and specific to the landlord's other tenant's in the building, which the landlord may want to pass on to the leasing dentist as part of the landlord's NNN cost.

The next type of lease that a dentist should be aware of is not a lease at all—it is an assignment of a lease. In many situations, a dentist is retiring and selling his or her practice and may want to assign the purchasing dentist the lease for the space in which the practice is operated, as opposed to the purchasing dentist negotiating a whole new lease with the landlord. If the landlord approves this, a lease assignment can be a great benefit to a new dentist in a transition, because the base rent on the space may have been agreed to years before with a rent amount that is below-market for the present value of the space. Nevertheless, all the concerns raised above still apply, and before simply taking the assignment of the lease, the prospective dentist should have the existing lease reviewed.

## Length of Lease

Deciding how long of a lease term is needed is one of the first questions a dentist should ask themselves when negotiating a lease. Before a dentist even starts talking with a landlord, they should confirm with their lender how long the term length needs to be. Most lenders in the dental industry will require the lease to provide the dentist with some formulation of ten years for the term in order for the dentist to be approved for a practice acquisition or start-up loan.

How the ten years is structured is up to the dentist. While longer terms have the benefit of locking in the fair market rental value of the space at that time, the downside is that if real estate market dips, the dentist could find themselves paying above-market rent for an extended period. For this reason, many dentists prefer to have a five year initial term, with at least one (but likely more) options to renew the term for five years each. When the end of the initial term approaches, the leasing dentist and the landlord will renegotiate the rent for the next option period (should the leasing dentist choose to exercise the option). This gives the dentist flexibility to leave the space and relocate if needed, but also to renegotiate the rent (and other terms of the lease) if situations have changed. An attorney experienced with dental practice leases will be able to assist in making sure the lease has provisions that fairly decide how the fair market rental value of the practice space will be determined for each of the succeeding options periods, so as to protect the leasing dentist from a landlord being unreasonable about the revised rent amount in the future.

## Specific Clauses and Terms

Although a commercial lease for a dental space may be anywhere from 15 to 80 pages, there are handful of clauses that any dentist looking to enter the real estate market should be aware of early on in the process. The first is the option to renew clause, which was discussed above. The second is the assignment clause. The assignment clause allows the leasing dentist to assign his or her interest in the lease to a new dentist in the event of a sale. The clause is important for several reasons. Perhaps the most important reason is the assignment clause is part and parcel of the leasing dentist's exit strategy.

Consider a dentist who is interested in "flipping" practices (i.e., buying struggling or underperforming practices, growing or combining them, and then selling them for a profit). This dentist would be wise to make sure that the assignment clause is present and reasonably drafted so that the lease can be assigned when the leasing dentist is ready to sell. The same is true for dentists nearing retirement who are negotiating the last lease of their careers, as they will likely want to make the sale to their future successor easier. A favorable assignment clause will make the sale of the leasing dentist's practice much easier years down the road and many practice valuation experts value practices at higher amounts when the practice's lease is easier to assign.

Another important term in a lease is the personal guaranty. A personal guaranty clause generally makes the dentist (as opposed to just the dentist's professional limited liability company or professional service corporation) personally liable for any default in rent under the lease. For most start-ups and practice acquisitions where it is the leasing dentist's first practice, a personal guaranty may be unavoidable. However, a personal guaranty can be structured so that it sunsets over time, is limited in amount, or phases down as the leasing dentist provides financial statements to the landlord showing the success of the dental practice. A dentist interested in selling his or her practice in the future should consider whether they will continue to be liable under the lease as a personal guarantor if they assign it to the purchaser of their practice, and an attorney can assist in making sure the personal guaranty is drafted in a way that allows the leasing dentist to walk away cleanly from the practice when the time comes. Negotiating this term early, can save a lot of stress in the future.

There are dozens of other important clauses and terms that should be considered and analyzed by an attorney, as although leases may appear boilerplate, each individual dentist is unique and has specific needs and wants that should be incorporated into the lease. Important terms and clauses dentists are often concerned with include, options to purchase the real estate, hazardous waste clauses specific to dental and specialty dental practices, a HIPAA clause to ensure that the janitorial service the landlord hires will be HIPAA compliant, signage terms for

the dentist's office, terms for how parking spaces will be allocated and whether they will be reserved or unreserved, and how the leasing dentist may audit the landlord's accounting of the NNN costs that are passed down the leasing dentist.

Although a real estate broker may negotiate the big points on a lease, many of these types of clauses will be in the "fine print" of a lease, so consulting with an attorney and having him or her review and edit the lease prior to finalization is crucial.

### **Upgrades and Rent Reduction**

When signing a new lease it is not uncommon to request upgrades and rent reductions. This is especially true in the case of start-up practices, where the space has not been built out for the leasing dentist. That being said, dentists stepping into an active practice in the acquisition context should not dismiss their bargaining power with respect to these items.

Upgrades are commonly referred to as "tenant improvements" and can be negotiated and memorialized in the lease in a number of different ways. A flat amount the landlord will spend in order to help build-out, renovate, or improve the space, is most common. The trick in any negotiation is negotiating not only how much, but how it will be paid. Most build-outs on a dental practice take several months. Landlords generally do not want to reimburse for tenant improvements until the end, when the landlord can guaranty that the work was done correctly and to code. A dentist in a start-up context should consider negotiating the acceleration of the reimbursement for the tenant improvements, either as the expenses are accrued or in installments, so the leasing dentist can have improved cash flow during the build-out phase. Making sure these complicated and dental practice build-out terms are correctly drafted in the lease is very important.

Even with practice acquisitions, it is not uncommon to ask for tenant improvements for items that are in need of renovation. Perhaps there is a popcorn ceiling from the 1980s in the practice that is unsightly or new carpets are needed. Identifying the number one renovation you would like made and asking for it to be taken care of or reimbursed by the landlord is not uncommon and an attorney will make sure this any terms like this are properly written into the lease.

In addition to tenant improvements, it is common for leasing dentists to negotiate a period at the beginning of a long-term lease where rent will be abated, if not reduced entirely. This is commonly done during the build-out period in a start-up practice, and is fair considering that the leasing dentist is incurring possibly hundreds of thousands of dollars in costs to turn the landlord's empty shell of a premises into a useable space. Negotiating and properly memorializing these terms in the lease are crucial. Is just the base rent reduced or is the base rent and the NNN amount reduced? For how long is it reduced? What if the dentist's build-out falls off schedule and he or she cannot open the practice before the rent reduction period ends? What if a permitting issue arises with the city? All these questions should be addressed in the lease.

### **Tenant Brokers**

Many dentists often ask if they need a broker and an attorney to help them with their lease negotiations. The answer to this question depends on the specific situation, but more often than not, having both can yield tremendous savings for the dentist over the term of his or her lease.

The broker will know more about what the fair market rental value should be for that space, since he or she will have expertise and knowledge about comparable spaces in the market. Likewise, they will have more inside knowledge with respect to what other tenant's in the building are paying, what terms they will be able to negotiate with the landlord, and what other practice spaces are available, all of which give the dentist tremendous bargaining power and leverage. Further still, many tenant brokers do not charge the dentist for their services—instead the broker's fees are paid by the landlord.

After the broker negotiates the “big points” of the lease, the attorney can assist in reviewing and identifying which specific terms need to be included in or struck from the lease, edit the lease to make sure it is consistent with the negotiations, and find opportunities in the lease to further protect the tenant. Structuring the lease negotiations this way can ensure that the leasing dentist saves money on professional costs, has negotiated a great deal on the practice space, and is protected under the lease for the term of the lease.

### **Expertise**

Dentists have more bargaining power than the average commercial tenant. As a profession, dentists have low default rates on loans and leases and prefer to have long term leases that many other tenants would rather avoid. Both these facts are important to any landlord assessing a prospective tenant and makes dentists an ideal candidate for a tenant. For this reason, a dentist should never just take the first offer that a landlord gives them with respect to a lease or sign whatever the landlord hands them. Instead, the dentist should fully leverage the dentist’s bargaining power in that situation.

It’s not unthinkable, on a ten year dental lease, that the leasing dentist will pay anywhere between \$500,000 to over \$1,000,000 on rent over the term of the lease. With a cost that high, spending the time and money to have a lease properly negotiated, reviewed, and drafted is the first step most dentists can take to ensure that their start-up or acquisition practice is a success. Working with an attorney who knows the specific needs of dentists and understands how their practices may grow and change over time, could save the dentist thousands in the long run and protect the dentist and his or her practice in the future.

**To learn more, contact our  
Business Group**

**[WWW.HELSELL.COM](http://WWW.HELSELL.COM) Helsell Fetterman LLP**

**Seattle** 1001 Fourth Avenue, Suite 4200 Seattle, WA 98154

**Bellevue** 10900 NE Fourth Street, Suite 2300 Bellevue, WA 98004