

# SAALFELD GRIGGS DENTAL INDUSTRY TEAM

## WHITE PAPER: MY LEASE MAY KEEP ME FROM SELLING MY PRACTICE?



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### I. Introduction

Interestingly, many dentists don't consider the importance of their lease or leases of business property when it comes to an eventual sale of the practice. We see leases take many forms. They run the gamut from a simple handshake to confirm a verbal agreement to extensive contracts that may run up to 50 pages in length. At the time that any lease is entered, the dentist has to consider the length of the commitment being made. Most dentists want to balance several key issues, including the following:

1. What is the length of the financial commitment being made?
2. How long do I want to be tied to this particular location?
3. If my practice grows, is there room for it to grow here, or will I need to move in order to expand?

These are only a few of the important questions that need to be asked, but they may be particularly relevant later when you plan on selling the practice. Typically, at the beginning of the lease, the issue at the forefront of the owner's mind is "How long will I be stuck paying rent?" For that reason, emphasis may be focused on entering into a short term lease. One key thing to remember is that the lease is a contract, a commitment of the tenant to pay the landlord for the right to use the space for a specific duration of time. Absent a default by the landlord, the tenant may not just abandon the lease without significant adverse financial consequences. Thus, an owner might think that the best bet is to even attempt to get a month to month lease so that there is maximum flexibility in being able to leave on only 30 days' notice. However, the problem with this approach is that the Landlord may also choose to end the lease on the same short notice, so the business is not protected. This is not something that the next owner of the business will want, and if at the time of sale a more suitable lease cannot be successfully negotiated with the landlord, your sale may fall apart. Further, given the significant investment in dental equipment and leasehold improvements involved in operating a dental practice, the cost of moving can be excessive, and being forced to move on short notice can be both damaging and disruptive.

Another consideration is whether the intent is for this location to be just a temporary stopping point along the lifespan of the business, or a long term place to stay and build the practice. If you plan on staying put, you have to consider the impact that growth of the practice will have on that location. Will there be room to grow? Can you grow your practice enough without a need to expand the space you rent? Should you rent more than you need now to secure the ability to grow without having to move in the future? Do you plan on addition other dentists to the practice which will require more operatories than you have room for? All of these things must be considered carefully at the inception of the lease in order to adequately plan and negotiate workable terms. Furthermore, you need to consider what your successor will want down the road when he or she takes over the practice. Your decisions may either add value to your practice, or in the worst case make it unsellable.

As a result of these important questions, we often see dentists make several possible mistakes. Sometimes, these mistakes may make little difference, but frequently they can and do result in unanticipated problems that prove costly. Consider the following:

## **II. Standard Form Lease**

How often does a landlord present a lease with the words, "This is just our standard form" clearly implying that review is unnecessary and that changes are neither welcome nor possible. If you succumb to this ploy and choose to forego legal review, at a later date you may find that several problems exist. For instance, the lease may not be assignable, and thus if you sell the practice, you have no right to transfer the lease to the new owner. This puts the landlord in a position of strength at the time of your sale and may force you to make costly concession to either the buyer or the landlord in order to get the deal done.

## **III. Long Term Lease**

Most dental practice purchases are financed over about ten years with a bank loan. The lender almost always wants some assurance that the new owner will be able to remain at the same location during the ten year term of the loan so as to avoid the high cost of moving which will adversely affect the buyer's cash flow. This may push the buyer toward signing a long term lease, but the fact is that the lender may be equally satisfied with a shorter lease with several renewal options. Most lenders will be equally satisfied with a five year term on the lease and one or more options to renew for at least five more years. Taking this approach can give the tenant more freedom and flexibility, while satisfying the needs of the lender at the same time. If you anticipate a sale, you want to be sure that your renewal options extend for a period long enough to satisfy potential purchasers of your practice.

## **IV. One Party Lease**

Landlords want to know who they are dealing with and have some assurance that they will have a say in who their tenants will be. For this reason, they often include provisions which restrict assignment and subleasing. However, this needs to be negotiated. Assignment may even be defined to mean a change of ownership of the entity that is the tenant. Thus, in a sale of the practice, even if it is a sale of stock in your professional corporation or an LLC membership interest, with such a provision included, the Landlord may create an impediment to the sale. Be careful to negotiate reasonable provisions which will permit an assignment of the lease or a sublease so as to enable a future sale of your practice. If the sale is of assets rather than the company itself, then you will want the right to assign the lease to the purchaser.

## **V. Conclusion**

We have seen recent cases pop up where tenants have not adequately thought through the question of what the lease should say when they had the chance. In one case, the dentist had a lease with two years left on the term, and an option to extend for only two years more. When he decided to sell the practice, the landlord would not agree to extend the lease because the landlord had expansion plans and needed the space. The tenant quickly found that the business was not as marketable as he thought because no bank would finance the buyer unless the buyer could demonstrate a right to continue to occupy the space for the 10 year lease term. Ultimately, although we represented the landlord, we were able to suggest an alternative that resulted in some compromise which met the needs of the landlord as well as the bank which permitted the deal to



close. Nevertheless, the selling dentist could have found himself up the proverbial creek without a paddle and forced to relocate the practice before selling. Had he been forced to do so, it would have severely reduced his net profit on the sale of the practice.

Of course this list is not exhaustive and there are many other questions that should be considered when leasing property. This includes negotiating for an option to purchase, rent escalation, payment of maintenance expenses, hazardous materials indemnification, restrictions on competing practices locating in the same office complex, personal guarantees, etc. There is a reason that leases are often lengthy documents – they govern the relationship of the parties for a lengthy period of time, and they are worthy of careful review and consideration before signing on the dotted line. We can't tell you how many times clients come ask us how they will get out of a lease that they blindly signed because it was just a "standard form" and thought that it would be easy to walk away later.

The lesson to be learned here is that when you consider entering into a lease, you need to realize that it will have implications that extend far beyond the first day of your occupancy of the premises. It may serve you well, or it may prove to be an impediment to growth and even the sale of your practice on the future. In each case, the best choice is to meet with your financial and legal advisors and carefully consider all the consequences of the lease agreement before you jump in and commit. Members of our Dental Industry Team regularly analyze leases and consult with our dental clients regarding these and other issues to enable them to make well informed choices.

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