

REMOVE  
BOOKLET  
ALONG  
DOTTED  
LINE

# HOW TO: GET A GOOD DEAL ON A LEASE

It may be a difficult time to be in business, but it's a good time to find a new space for a business. As with housing, there is a glut of commercial real estate on the market. "Two years ago, it was a whole different market. It was more of a landlord's market," says Andy Fried, a consultant at the Kennesaw State University Small Business Development Center and a commercial landlord himself. "Today, it's all a tenant's market. There are no rules. Asking for 12 months' free rent is not absurd."

That's right: free rent. A commercial lease is a long and complex document, and negotiating one can be daunting. But a prospective tenant has a great deal of leverage at the moment. It has always been true in principle that everything in a lease is negotiable. Now, it's true in practice, too.

Even if you are a strong negotiator, however, don't try to go it alone. A good broker is essential, because he or she will know what landlords in your area have been offering to lure tenants. And, because brokers have conflicting loyalties (see "Of Brokers, Beware," last page), you will also need a lawyer who knows commercial real estate. "Brokers tend to like the lease—they don't tend to bring things up unless you do," says Ned Harper, director of the Daytona State College SBDC. A real estate attorney, on the other hand, "has seen what clauses are going into contracts. He's the one who's written them."

# NEGOTIATING A LEASE

## 1. Set Terms; Get Free Rent

Your first order of business is to negotiate the term, or duration, of the lease and the rent you will pay, which is usually figured per square foot. Leases typically include an option to renew at the end of the term, at either a specified rent or “prevailing market conditions.” (Some retail landlords, particularly mall owners, stipulate a so-called percentage lease, or overage, whereby tenants pay a minimum rent plus a share of gross sales.)

Small-business advisers generally recommend the shortest term possible: one year, with as many as 10 one-year renewal options. The rent does not necessarily increase with each option—that, too, is negotiable. The advantages of a short-term lease are clear: Your business won’t be trapped in a space if things don’t go well—or go so well that the business needs more space. The disadvantage is that landlords are less likely to grant concessions to tenants that won’t promise to stay for, say, five years.

But for businesses that are willing to sign longer leases, those concessions are increasingly substantial. In Atlanta, for example, “a landlord now figures that it could be as much as a 12-month investment to get a new tenant up and running,” says Fried. Part of that investment is spent, as always, in the form of a broker commission, but the rest goes to the lessee as free rent and tenant-improvement, or build-out, allowance.

Commercial properties are generally valued according to the square-foot rental rates in lease contracts. As a result, says Annette Cooper, an agent

with Keegan & Coppin in Santa Rosa, California, landlords like to hold firm on the contracted monthly rates even while they offer rebates off the monthly rent. Of course, as far as you are concerned, a deal is a deal, no matter its structure—at least in the short term.

Measure the space before you sign a lease, Cooper advises. “Spaces have sometimes been reconfigured three or four times, and often they’re going off an old floor plan that’s not accurate,” she says. Leases, she says, sometimes explicitly limit redress for a tenant that finds out after the fact that it’s paying for more space than it actually has.

## 2. Mind the Extras

**Expenses:** Landlords tend to pass on expenses to their tenants, one way or another. In a triple net, or NNN, lease, the landlord bills separately for taxes, insurance, and operating expenses or common area maintenance, or CAM. Expenses are prorated among tenants according to their share of the total space. CAM is usually broadly defined; besides upkeep for shared facilities such as the parking lot, lobby, stairwells, and restrooms, it can also include virtually any operating expense.

Be aware of which expenses your landlord proposes to bill, particularly as part of CAM. “I’ve seen lease documents that include depreciation as a CAM expense, and that doesn’t seem right to me,” says Cooper. Ensure the right to see for yourself the expense budget, as well as which costs are actually incurred. Utilities are also borne by the tenants. In shopping centers, tenants are metered individually; in office buildings, utility costs are apportioned by square footage.

A gross lease, by contrast, includes everything—at least in theory. This term, too, means different things to different people. For instance, to some brokers, a full-service lease is synonymous with a gross lease; others say full service includes utilities but gross does not. And gross leases will usually pass on annual increases in expenses. Either way, make certain that your expenses won’t increase within the first 12 months of your occupancy.

**Maintenance and repair:** Most landlords attempt to hold tenants responsible for maintenance and repairs of anything other than the roof, exterior walls, and parking lots. Some require renters to replace failing equipment, including the heating, ventilation, and air conditioning systems, a potentially enormous outlay. If the building is approaching 10 years old, or the HVAC systems have seen inordinate use (in an especially hot climate, say), get the HVAC systems inspected, along with the plumbing and electrical equipment. If you find problems, make it a point of negotiation. “If a tenant brings it up, I’m flexible,” says Fried.

## 3. Plan an Escape Clause and Other Provisions

Leases almost always favor the landlord. But you can build in clauses that level the playing field. Be strategic in setting priorities. “I try not to make wholesale changes, because they’re not likely to be accepted,” says Rick Gier, a lawyer in Overland Park, Kansas. “I’m more concerned with

## Leases almost always favor the landlord. But you can build in clauses that level the playing field.

making four or five important changes than 20 small changes.”

**Co-tenancy:** Many shopping centers rely on big anchor stores to draw traffic. So what happens to the smaller tenants when an anchor closes its doors? A co-tenancy clause lets a renter escape the lease if the landlord doesn't replace the anchor in a specified period.

**“Good-guy” clause:** In exchange for a personal guaranty, a good-guy clause

holds a tenant that defaults on a lease liable only for the rent owed before the renter vacates the property, rather than until the lease ends. Good-guy clauses are popular in New York City but are less common elsewhere.

**Personal guaranty release:** Most landlords will insist on a personal guaranty from the tenant. As an alternative to a good-guy clause, ask for a release from the guaranty after, say, two or three years.

**Exclusivity:** An exclusivity clause guarantees a direct competitor won't move into the same development.

**Sublease:** A sublease allows a tenant to sublet space to a complementary business. A salon, for instance, might sublet to a massage business. “A sublease allows you to turn your fixed costs into variable costs,” says Harper.

**Guaranteed selling points:** Landlords often make a selling point of high occupancy rates or a large number of monthly visitors. Harper recommends getting these in writing and exacting concessions (including the freedom to leave) if the landlord falls, say, 20 percent below the guarantees.

# THERE ARE NO SHORTCUTS TO SUCCESS JUST HYPERLINKS

Visit [DELL.COM/SB360](http://DELL.COM/SB360) to download the free monthly *Inc. Guidebook*. And find valuable tools and tips for growing your business.





# OF BROKERS, BEWARE

You may have recruited your broker, but your broker isn't necessarily working for you. He is working for the landlord who pays the commission—in most markets from 5 percent to 6 percent of the total lease value, split between the landlord's listing agent and the broker who introduced you to the property. Here are other things to keep in mind about brokers:

- **Listen to your lawyer.** A good real estate lawyer—who really does work for you—can recommend brokers who will advise you in good faith.
- **Trust but verify.** Small-business counselors advise against leaning too heavily on your broker when it comes time to negotiate. "Most brokers will do whatever it takes to get the deal signed and don't want to add complexity," says Harper. All contract details should cross your lawyer's desk.
- **Don't go it alone.** The previous point notwithstanding, negotiating on your own behalf won't put extra money in your pocket. The share of the commission that would have gone to your broker will just go to the listing agent. And you could miss opportunities for concessions.
- **Make sure your broker has experience in your market.** Commercial real estate divides into three segments: retail, office, and industrial. Each involves different issues and market trends. The amount of free rent available, for instance, will vary both by geography and market.
- **Keep your options open.** Some brokers will insist on an exclusive representation agreement. Resist it, says Harper. If you do sign a tenant representation agreement, your hands are pretty much tied, he says.

## NOTES:

---



---



---



---



---



---



---



---



---



---

# RENEGOTIATE NOW

Even if you are locked into a lease, you still have leverage to renegotiate, particularly in the current environment. Given the time and cost involved, most landlords will be reluctant to sue a tenant that is forced by circumstances to break a lease, says Fried. Moreover, he adds, "it takes time to find somebody new, and when they find somebody, they're going to want free money." In other words, a landlord has a lot of incentive to work out a deal if you can convince him or her that you are going through a tough period.

That said, some negotiating tactics are better than others. "Most landlords are willing to do something that's short term," says Cooper. "You're more likely to get something like a 25 percent rent abatement for the next six months than getting your rent reduced for the rest of the lease."

### Resources

The Center for Commercial Real Estate ([cfcre.com](http://cfcre.com)) offers a comprehensive guide to leasing property, including a glossary for decoding industry jargon.

[OfficeSpace.com](http://OfficeSpace.com) provides real estate listings in seven U.S. cities and valuable resources for a prospective tenant, including FAQs and a glossary.

Study up on your market at [LoopNet.com](http://LoopNet.com), which lists 650,000-plus properties for sale or lease nationwide. A 24-hour membership for searching costs \$30.

Your local economic development authority not only can provide information about the real estate market but may also offer incentives for opening or relocating a business.