Negotiating Lease Extensions

To the delight of landlords everywhere, many business owners and corporate executives view making real estate decisions to be more of a chore than the priority they should be. As a result, otherwise well-prepared decision-makers find themselves unprepared to act in a timely and informed manner … leading to over-paying. *Cha-Ching!* This discussion sets forth a three stage process commercial tenants can utilize when making the decision to either extend their lease or relocate the business; as well as how to neutralize the tactics landlords and their property managers employ when negotiating lease renewals and extensions.

Stage 1: Evaluate your present and projected requirements.
Now is the time to evaluate your space/location/budget requirements with fresh eyes. Start by taking a look around you. Is the layout efficient? Can seldom-used files be stored offsite (at a lower cost)? Would additional work area help create greater revenue, or are you paying for unproductive space? And while you're at it, start sizing up the landlords circumstances. Ask yourself if relocating would have a significant impact on the landlord's cash flow … or negatively affect selling/refinancing the property. Answering "yes" means you possess negotiating leverage … more on this topic later.

Deconstruct your present lease. What was left out? Common omissions include: options to extend, the right to assign both the lease and any options, early termination provisions, eliminating or minimizing personal guarantees, warranting of the air conditioning system(s), the first right to expand into adjacent space, and an accurate definition of how market rate is to be calculated.

Stage 2: Educate yourself on market conditions.
Unlike purchase prices, which are part of the public domain, lease terms and conditions are proprietary and not available in *any* database. Too, as a matter of policy, landlords forbid property managers from disclosing the details of other leases. Further, fewer than 5% of the available spaces for lease are advertised to the general public. This *intentional* scarcity of comparative data makes true arm's length commercial lease transactions (where the parties are dealing from equal bargaining positions) almost unachievable; as the uninformed, and generally under-represented tenant is pitted against the well-informed property owner, its property managers and agents. Care to speculate which side has the bargaining advantage?

The market rate myth. Listing agents, property managers and landlords commonly refer to their "asking" rate as the "market" rate – I call it sticker price…the amount only an uninformed person would pay. That's because market rates do not reflect the discounts that purposeful negotiating can achieve, which include rate reductions, free rent, tenant improvements, and other unadvertised inducements. In short, the market rate always overstates the landlord's anticipated "getting" rate. So stop thinking market rate and start thinking in terms of reductions and concessions.

The high cost of re-tenanting. Your rent represents revenue to the landlord…whose goals are to maximize the income stream and minimize expenses. The direct and indirect costs associated with leasing space include: leasing commissions; an indeterminate vacancy period; tenant improvement costs; legal, administrative and advertising expenses; and a free rent period. Taken together, acquisition costs can easily reduce a landlord's projected revenue by 15% to 25% of the gross value of a lease. Therefore, the decision a landlord must make is whether it would be more cost effective to accept your aggressive proposal, or hold out in the hopes another tenant will come along who is willing to overpay.

For the fully-informed tenant, it's always a tenant's market. Those yard signs in front of almost every building confirm that there are more vacancies than there are tenants to fill them. While signs seldom disclose sizes or prices, and vacancies are continually changing, compiling accurate and complete information is essential to making fully-informed leasing decisions.

Stage 3: Negotiate on the current space and the best alternatives.
Waiting for landlords or property managers to initiate contact is a poor strategy…and plays into their hands. Many property managers purposely delay extension discussions until the tenant no longer has adequate time to perform essential due diligence, or conduct meaningful negotiations on other properties. I call this tactic negotiation by ambush, because it forces the tenant to either extend the lease on the landlord's terms, or incur significant holdover penalties, which are typically 150% to 200% of the present rental rate. So plan ahead, and don't allow yourself to be trapped in a last minute crisis negotiation. TIP: Start the negotiation process at least six months prior to your expiration date. In the event you are unable to come to terms with your present landlord you will need 90 to 120 days to plan and execute a move.

Choose the right negotiator. You are not buying goodwill by self-representing…just opening yourself to overpaying. Consider taking a page from the landlord's playbook and protect your interests by engaging the services of an independent real estate advisor; one whose professional experience and skill set are consistent with your needs, i.e., achieving the lowest overall occupancy costs. Note that all agents who list properties are de facto employees of landlords, and have insurmountable conflicts of interest when also attempting to represent tenants.

Let's make a deal! I suggest conducting simultaneous negotiations on every suitable building, paying particular attention to those properties with the highest *apparent* vacancies, as they are the most likely to agree to the lowest rates and deepest concessions. The terms and conditions available from competing properties represent your strongest leverage when negotiating with your present landlord.

Insist on receiving concessions and courtesies available to new tenants. Buildings are really pretty much the same. Therefore, commercial real estate should be viewed as a commodity in which the low-bidding landlord wins. That is to say, tenants should gravitate to the landlord offering the lowest *overall* occupancy costs for the type of building they seek. For those considering extending their leases this means making the landlord compete as hard to retain your tenancy as they did when first courting you…and agree to terms and concessions available from other landlords. An in-depth discussion of this topic is available in the Articles section of www.crossrealty.com.

Closing Comments: Commercial buildings, like hotels, airlines and other businesses, set their rates based on demand, and there can be wide fluctuations. So, before you find yourself fluctuated, make certain you have a clear understanding of how the leasing process operates … and what steps you can take to make it work for you. Resolve now to make your next lease better than your last. SAN

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