

# Real Estate Strategies

Martin Property Advisors, Inc | Phoenix

## Five Secrets for Successfully Negotiating a Commercial Lease

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**M**OST COMMERCIAL TENANTS CONSIDER LEASES TO BE AN ADMINISTRATIVE HASSLE. THE FASTER THEY CAN MOVE THROUGH THE IRRITATING PAPERWORK, THE FASTER THEY CAN MOVE ON WITH BUSINESS.

But with real estate overhead the second-most expensive line item for businesses, negotiating leases should not be taken casually, particularly for commercial tenants renewing their commitments for an additional 5-10 years.

Aggressive landlords can increase a company's rent and related expenses by more than 50 percent at each renewal. Landlords attempt to impose all costs, risks, and inflated profits to their commercial tenants, and most tenants simply sign on the dotted line, quickly committing to long-term, expensive leases in exchange for few and minor concessions.

Why rush to sign an agreement that clearly favors the landlord? The end of a lease is a time for companies to take stock of their real estate situation and leverage the alternatives, like leasing in another building or buying a property.

Tenants should take a strategic approach by following five basic steps for negotiating a commercial lease:

### 1. Quantify the landlord's costs if the tenant vacates.



It is always in the landlord's best interests to renew your lease. Construction expenses, space planning and permitting for a modest retrofit cost conservatively \$20 per square foot (PSF). Preparing space, advertising and negotiating a 10,000-square-foot (SF) space for a new tenant may cost \$450,000 to \$600,000, or \$45 to \$60 PSF. Compare this to the \$6 to \$9 PSF concession package used to entice tenants to renew. A tenant renegotiating a lease can generally bargain for much more than a new paint job and a few

minor frills. Clearly, landlords do not want tenants to be aware of this.

### 2. Ignore bullying tactics.

Landlords know that a professional tenant representative will educate the tenant—at the landlord's expense. To avoid this, landlords often approach their tenants early. They propose two sets of lease terms: a lower rate if the tenant has no representation; or higher rent for broker-negotiated deals. The landlord blames the difference on commissions, which is not true.

Getting a tenant representative involved early in the process will save you money. Tenant representatives are more likely to save you money than just hiring a lawyer.

### 3. Conduct due diligence.

Even tenants with no desire to relocate should conduct due diligence of market conditions. Knowledge of the quality, quantity and cost of relocation opportunities provide negotiating leverage.

Under the true logistics of your office space needs. Different companies have different space requirements. Not all tenants fit efficiently into all buildings.

A large insurance company might fit will into a 70,000-square-foot floor, but the same large floor could be extremely inefficient for a 10,000-square-foot mortgage company. Use your broker and architect early in the process to help determine your company's needs. An appropriate floor size and shape can reduce a tenant's square footage by 10-15%. That's about \$180,000 in savings for a 10,000-square-foot tenant over five years.

Tenants must carefully select their commercial tenant representative—only hire an exclusive tenant representative. Most brokers derive their revenue from representing landlords in managing, leasing, selling, and refinancing. These brokers seldom aggressively negotiate on behalf of a tenant. True tenant reps have no conflicts because they don't accept work from landlords.

Interview several tenant representatives. Look for experience, references and chemistry. Be certain they're more than a marketing expert, and insist that they personally handle your assignment.

#### **4. Consider the true cost.**

Failure to properly negotiate a lease can cost a 10,000-square-foot tenant \$300,000 over five years. Tenants should consider square footage calculations, option language for expansions and extensions, detailed landlord responsibilities, appropriate base year calculations, tax protection, and exclusions from operating expenses—issues best negotiated by an exclusive tenant representative.

#### **5. Take the initiative.**

Generally, if a tenant with an expiring lease waits for the landlord to approach them, they've waited too long. The due diligence necessary to effectively negotiate leverage takes at least 18 months, so start negotiations two years before the expiration date. The entire process should be finalized no later than six months prior to lease expiration. Be proactive—send a clear message to your landlord: you have committed the time, energy, and resources necessary to secure the best terms for your space. You landlord must consider your needs—or another landlord will.

#### **A Success Story**

Paul Wylie, founder and former owner of Metrocities Mortgage, LLC, grew his six-man company to 1400 employees and over \$10 billion in financial services.

Despite Wylie's inside knowledge of the real estate industry, the 200-page commercial lease agreements he was presented with when negotiating rental space for his company were overwhelming. Instead, Wylie hired ITRA/Guardian Commercial Realty, which saved Metrocities Mortgage approximately \$3 million over 15 years.

"They negotiated things I did not know were negotiable," said Mr. Wylie, adding that his agent identified and removed sections of the lease that would have been financially detrimental to his firm.

*\*This article was edited for publication. Robert Chavez may be reached at robert.chavez@guardianusa.net.*