

# **Negotiating Commercial Property Leases**

## **A Tenant's Guide to Leasing Commercial Property**

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# Introduction

This book is written to de-mystify the commercial leasing process for the commercial tenant. Commercial building owners and their Agents (who have been very carefully chosen) each have a strong background in negotiating these Leases, which most commercial tenants lack. I've observed that many times when a prospective tenant finds space on their own they simply do not know how to go about leasing the space and must rely upon the owner or the owner's broker to get them through the process. Sometimes this works, but because of the inherent tensions between landlord and tenant in a negotiation the transactions often fail. This guide will help equalize that situation and show you what to do and how to proceed when you want to find an office, industrial or retail space to lease on your own.

Whether you are leasing commercial property on your own or using the services of a broker, this book will serve you well because leasing is a very different kind of real estate transaction. In most real estate transactions some form of binding agreement is made early in the process, such as in the purchase of property. A buyer tenders an offer in writing with a purchase contract and deposit receipt to the seller. The seller accepts or counter offers which go back and forth until there is acceptance. When the terms of this binding contract have been met, the property transfers to the buyer. While this sometimes happens in leasing, most often, a series of non-binding proposals go back and forth outlining general business terms and, at the end of the leasing process, a rather lengthy contract is produced. This contract, when executed, defines the ongoing rights and obligations of the parties to each other for a period of time. During the time the transaction is being negotiated, reviewed by legal counsel and finally completed, there is much to do and much that can go wrong.

This book will take you through the steps involved in the leasing process; teach you about the most important business points in a lease negotiation; show you how to create winning proposals; and give you some useful negotiation tips. I've also included some useful checklists and defined the jargon for you. Leasing commercial property on your own is not overly complex, but it does take some knowledge and skill. Not surprisingly, the owners or their brokers will have that knowledge and skill. Therefore, you must level the playing field and this book will help you do that.

## , About the Author

William Small, JD, CCIM, started his successful commercial real estate brokerage, consulting and development career in Washington, DC in 1985. As one of the top commercial brokers in the Washington, DC market, Bill negotiated hundreds of leases and investment transactions representing major national and international developers, tenants and investors in the purchase, leasing and sale of major development sites and office buildings in downtown Washington, DC, a 100 million square foot office market.

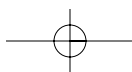
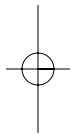
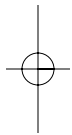
He's provided real estate consulting and investment advisory services to major U.S. and foreign corporations and institutions such as Bank of America, the United States Mint, Times Mirror Corporation, Blue Cross Blue Shield, the National Rifle Association, City of Aspen, J.E. Robert Companies, Costco and the National Association of REALTORS. Bill earned a Juris Doctorate degree from Seattle University School of Law and is a member of the Washington, DC, Maine and U.S. Supreme Court Bar Associations. He has served as Chairmen of the DC Bar Associations Commercial Real Estate Committee and President of the Greater Washington, DC Council of FIABCI, the International Real Estate Federation.

He's also an active member of the Commercial Investment Real Estate Institute, holding the CCIM designation, and holds real estate brokerage licenses in California, Colorado, Virginia, Maryland and Washington, DC. Bill currently resides in Aspen, Colorado where he specializes in commercial real estate brokerage, investments and development in resort areas. Bill is currently the Managing Director of Frias Commercial Real Estate and President of Aspen Capital, LLC, a real estate investment and development firm.

***Authors note:*** This book assumes that you will be working on your own to lease the commercial property you want. This book will also be very useful to you if you are working with a broker because it will provide you with a clear understanding of the process and will help you benchmark where you are in the leasing process. In either case, use it as a tool to make sure all the important aspects regarding your transaction are covered to your satisfaction.

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# 1

## A Word about Commercial Property Brokers

Using a qualified commercial property broker will save you time and money. Not only will your broker do much of the grunt work involved in the leasing process, they also have a deeper market knowledge and better market information. By using this guide, you will be better able to manage your broker and your transaction. You will have a better understanding of the process and know what to expect. This will put you in control of your transaction and, since you are the one who lives with the lease, control is exactly what you need.

As you start the process of finding a commercial space you will encounter commercial brokers, some of whom will offer their services to you. It is vital that you are clear on whom the broker is representing in your transaction. Real Estate brokers are either specialists or generalists. In leasing you need to be working with a specialist if you are using a broker. Essentially, commercial leasing brokers fall into two categories: full service brokers who can serve as agents for both landlords and tenants; and tenant only representatives (“tenant rep”). The last is a minority in today’s market as most brokers offer full service assistance.

You are also likely to encounter the in-house building representative who is not an agent of the owner but is an employee. Employees do not have a fiduciary duty to any party in the transaction, often are not real estate licensees, and act in the best interests of their employer. When encountering anyone representing a property of interest to you, be sure to ask if they are an agent or an employee of the owner.

It is likely that if you interview several brokers before beginning your search for new space, you will encounter both the full service broker and the tenant rep broker. The key to selecting any broker is experience. Often the tenant rep's strongest selling point is that because they represent you, they can get you the best deal. A thorough understanding of how agency affects the lease negotiations will clarify this statement.

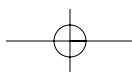
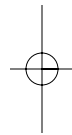
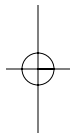
The source of an agent's compensation, if any, does not solely determine agency. Agency is an action. That means, if a real estate licensee acts as someone's agent, they become their agent. A broker owes their principal a fiduciary duty, or in other words, an absolutely faithful duty to perform in the best interests of their principal and to do no harm. They also have a duty of honest and fair dealing with all other parties in the transaction. Dual agency occurs when one agent works for two opposing parties in the same transaction, in this case the landlord and tenant. Dual agency must be disclosed and all parties must agree to accept the dual agency scenario. Any broker, even a tenant rep, can inadvertently become a dual agent in a transaction by performing an act for the other party.

Whether a broker works for a full service brokerage or a tenant representation brokerage, the agent's fiduciary duty is always to their principal. Either can inadvertently end up as a dual agent in a transaction. That is why experience is the most important factor in selecting a broker. In evaluating experience, consider both the depth and the volume of experience. A full service bro-

ker, because they often represent several local properties, receives as well as initiates transactions. They develop strong problem solving and negotiating skills because they are experienced with both sides of transactions. Furthermore, full service brokers will often work on more transactions annually than their tenant rep counterparts.

Brokers are paid upon the completion of the transaction, and not paid if the transaction fails for any reason. There are two ways that commissions are calculated, a percentage of the rent for all the years of the lease or a certain number of dollars per square foot, based upon the lease term. For example, when the commission is based upon a percentage of the total value of the lease, the annual base rental cost plus pre-established annual rent increases is calculated for the term of the lease and the commission is a percentage of that total value. At some point, the commission might be reduced by a certain percentage if the lease term is greater than a certain period of time, such as ten years.

Commissions are usually paid either as fifty percent upon lease execution and fifty percent upon tenant occupancy, or paid out over the term of the lease with the broker receiving an agreed upon percentage each month or quarterly. If you plan on using a broker, I suggest you select one qualified specialist in the area and type of property you desire and enter into an exclusive agreement with that broker. Since the broker is only paid when a transaction is completed, your agent will be better able to dedicate his time to your assignment if he knows you are committed to working with them. I also suggest that you put your agreement in writing and include the right to terminate the agreement on thirty days written notice. In this way, you can end the relationship quickly if your broker is not doing an outstanding job for you. Brokers are very useful and can save you time and effort and that translates into money.



# 2

## Timing Your Transaction

Begin your relocation process early, because you will be conducting business as usual during this time. You should begin your relocation efforts 4-8 months before your move date. By planning well in advance, time will be your ally, not your enemy.

If time becomes an issue, keep cool, because most economic concessions are made right before the deadline of the transaction. You should avoid telegraphing your need to close the deal quickly. Attempt to work out a short term extension with your existing landlord rather than reveal that you are under time pressure.

Allow enough time to accomplish all of your objectives by establishing a time line of the leasing process. Here is a quick overview of the process. Based upon how much time you actually have to accomplish your move, you may have to compress the time frames suggested.

### **Week 1**

Develop a complete definition of your requirements. This could include meeting with all of your managers and department heads and perhaps your own architect. If you are planning to use a broker, conduct broker interviews.

## **Week 2**

Begin to survey the market and locate available properties that meet your requirements. Conduct inspection tours of the most qualified properties.

## **Week 3**

Begin making preliminary proposals and open negotiations. Commence the space planning process, allow one to two weeks turn-around time for plans. Cost estimates can take up to another two weeks.

## **Weeks 4-5**

Begin reviewing responses and evaluate the counteroffers. Review space plans, and cost estimates.

## **Weeks 5-6**

Once an economic agreement is reached and space planning is completed; it will typically take two or more weeks for review of the legal documentation.

## **Weeks 6-8**

Lease contract negotiations take place. If all has gone smoothly you could find yourself at the point of signing a lease.

## **Weeks 8-11**

Working drawings for your tenant improvements, based upon previous iterations of your space plan, will begin after lease execution. Allow two to three weeks for these plans to be completed.

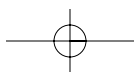
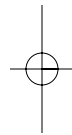
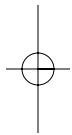
## **Weeks 11-14**

Permits and any required engineering can take from 2 to 6 weeks (or longer) depending on the various approvals required. Some owners will start construction upon application for permits to expedite the occupancy.

## **Weeks 14-26**

Depending on the size of the job you should allow 8 to 12 weeks for the physical construction.

Based on this typical time line, you should allow 19 - 26 weeks for relocating, if everything goes very well. If time is short, there are some short cuts to compress the time required, but they may be more costly. Another alternative is to limit your choices to buildings with space that comes very close to your needs and requires only minor alterations. You can also look for sublease space meeting your requirements.





# 3

## The 8 Steps of Commercial Leasing

1. **Define your requirements**
2. **Locate suitable property**
3. **Tour properties**
4. **Make a proposal to lease**
5. **Space planning and architectural evaluation**
6. **Analyze responses**
7. **Negotiate the lease contract.**
8. **Close the transaction**

### Define your requirements

There are a number of important questions to ask to accurately define your requirements. Doing this in advance will save you time and avoid starting in the wrong direction. Committing your requirements to paper will also help you as you visit properties to make sure nothing is overlooked. As a broker, there are a number of questions I ask my clients to move from a rough idea of their needs to a clearly defined objective. You will use this information to screen out unsuitable properties once you start to make calls on available sites.

## Location and General Questions

- *What geographic area(s) is of most interest to you?*
- *What particular buildings are of interest?*
- *Is an office with a view important? If so, what is the lowest floor to which your company would be willing to locate?*
- *Visibility from the street and sidewalk?*
- *How many square feet will be leased?*  
*(A table follows for calculating your requirements)*
- *How many people will be employed at this location?*
- *What is your annual budget?*
- *What length of lease is preferable?*
- *Is future expansion important?*
- *When does your company intend to move?*
- *When does your existing lease expire?*
- *What are your parking and transportation needs?*
- *What modes of transportation will your employees use?*
- *Do you need to be within walking distance to public transportation?*
- *Do your clients visit often?*
- *What kind of image would you like to establish?*

## Space Configurations:

- *Number of private offices*
- *Sizes: Executive \_\_\_\_\_ Associate \_\_\_\_\_ Sales \_\_\_\_\_*
- *Retail space size and layout?*
- *Number of open area work-stations:*
- *Sizes: 8x8 8x10 10x12 10x15 other*
- *Number of conference room(s); sizes:*
- *Number of storage/supply room(s); sizes:*
- *Number of file cabinets; sizes:*
- *Number or size of computer room(s)*
- *How large a reception area is required?*
- *Do you have any special electrical requirements?*
- *Do you require any above-standard tenant improvements?*
- *Other special requirements?*
- *Electrical needs*
- *Communication needs*
- *Special H.V.A.C. (heating, ventilating and air conditioning)*
- *Training rooms*
- *Americans with Disabilities Act compliance*

When you are touring potential locations to lease, you are likely to be asked some qualifying questions. You might want to think about what information you are prepared to give up and

what you will want to hold back. In a negotiation, information is king and giving up too much too quickly can compromise your bargaining power, especially if time is short.

***Typical qualifying questions owners might ask you:***

- *When does your lease expire?*
- *What is your budget?*
- *What else have you seen?*
- *Are you working with any brokers?*
- *Why do you have to move?*
- *Do you have any other options?*
- *Where does the company leadership or employee base live?*
- *Who are the other decision-makers?*
- *What is your business history?*
- *What is your financial condition?*
- *What are your growth plans?*
- *What doesn't work about the space you now have?*

Generally, you will already have some idea of how much space you need based upon prior experience, research of competing businesses, or franchiser provided guidelines. For retail, warehouse or industrial users, it will be based upon the amount of space required for the displays, storage of goods or the placement and size of equipment.

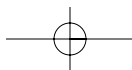
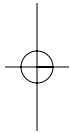
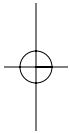
Deciding how many square feet you will need is the next

step in starting your search for space. As a rule of thumb, for office users, plan on between 150 to 250 square feet per person.

Use	Usable Sq. Ft. Per Person	Estimated Size	Number of People	Total Sq. Ft. Requirement
Sr Executive	250 - 400	x	=	
Executive	150 - 250	x	=	
Private Office	100 - 150	x	=	
Partitioned / Open	50 - 100	x	=	
Conference Rooms	25 - 30	x	=	
Reception Rooms	100 + 25 / Guest	x	=	
Kitchen / Lounge	50 + 15 / Person	x	=	
File Room	7 Per File	x	=	
Other		x	=	
Subtotal	—	—	—	
Circulation / Load Factor	Add 33% Subtotal	—	—	
Total Required				

To get a more accurate feel for your square foot requirements, use the chart below to calculate your needs. Select your anticipated square foot usage from the range given for each use and multiply it by the number of people needing that configuration. Generally, leases run from five to ten years so remember to anticipate personnel growth in your calculations.

After you have completed the math for all your uses; add 33% to the total to compute the circulation for corridors and the load factor.



# 4

## Locating Suitable Properties

If you're not using a broker, then the Internet is a good place to start in developing a market survey report. There are a number of decent searchable web sites you can access and most of them will come up on a search with some common key words such as office space, industrial space and retail space. One of the most popular currently available is [www.loopnet.com](http://www.loopnet.com) and is a good place to start. I suggest you go on line and get familiar with how these sites work.

You will also need to check the local newspapers and drive around the areas you'd consider suitable for your business. The best time to drive the market is early Sunday morning. There is virtually no traffic, it's easy to pull over and capture an address and phone number. I suggest a small tape or digital recorder for this job. Not only is it faster and easier, but it will allow you to record a few comments about the building and its location. This will be useful later when you make your screening calls. For the super high tech, using a digital camera with voice recording capacity will definitely save you time and effort when deciding which properties you will want to visit.

### **Pre-screening and selecting properties to visit**

Naturally you will want to see the properties that most closely meet your needs. Therefore, be prepared to ask the important questions first. I suggest that you review the list of questions you

used to define your requirements and put them in the order of importance. A simple ranking system will do. Put a three next to any thing you cannot live without, a two next to anything that is very important but you might be able to work around, such as re-configuring the space in some way and finally, a one next to anything that is desirable but not necessary. By doing it this way you can use a high point system to decide which properties to visit first, which are on your second tier list and which ones to eliminate.

Before you can begin to make calls on properties, you will need to understand a few basics about lease rental rates.



# 5

## Understanding Rental Rates

Because there are a number of factors that comprise rents and several customary ways to quote rents, it can be difficult to understand what people mean when they are discussing leasing rates. Normally, the rate quoted reflects the amount of rent you pay per square foot. Generally square foot prices are quoted on an annual basis, however, some markets quote on a monthly basis. By example, a \$36.00 per square foot annual rate is equal to \$3.00 per square foot when expressed as a monthly rate. While this is simple math, it can come as a bit of a shock when you hear a rate quoted for one space as \$3.00 per square foot and another as \$36.00.

The rate quoting style tends to vary: Urban office leasing is generally quoted as an annual rate, while industrial and retail are typically stated as monthly rates. Also important to note is that real estate brokers commonly refer to annual square footage rates while tenants frequently prefer to look at rates on a monthly basis. This difference may occur because each uses the rate differently. Tenants commonly look at their expenses from monthly expense perspective, while agents deal in leasing agreements in annual terms. Aside from different rental rate terms, there are key attributes associated with each square footage rate.

These attributes are most commonly referred to as: Full Service Gross, Industrial Gross (or Single Net), Double Net and Triple Net (or Absolute Net); all of these except the Full Service Gross rent may have Common Area Maintenance (CAM) charges added on. On property fact sheets you may see these written as; FSG, IG, N, NN, NNN, CAM. These attributes determine who pays the utilities, janitorial and other building services (elevators, common hall lights, etc.) and are key factors in determining the true asking rate.

*Note:* Retail tenants may also be subject to a percentage rent that requires the tenant to pay a percentage of the gross sales. Typically this kicks in after the yield of the percentage of gross sales exceeds a certain minimum rent.

*Full Service Gross* is generally associated with urban or multi-tenant office buildings indicating that the asking rate includes all the building services, utilities and janitorial, property taxes, insurance, and common area maintenance.

*Industrial Gross* (sometimes referred to as *Single Net*) is associated with office/warehouse and some small office buildings and this rate generally means that the tenant pays for its own utility services, janitorial and trash removal, while the owner is covering the property taxes and insurance.

*Net* generally indicates what the asking rate does not cover. For example net of utilities and janitorial means that the tenant is, at a minimum responsible for its own utilities, janitorial, plus the base rent. I do not think there is anything about leasing that causes more confusion than the term *Net* because it is so often misused, even by otherwise competent brokers. So let me make this really easy for you and save you some real grief later. When you hear the word *Net*, think the word *Not*, or in other words, something is not included in the rent. You then need to ask this question: "Please tell me all the things I will be paying for that are not included in the rent." This will be essential in comparing the final

cost of leasing one property over another.

*Double Net* is a commonly used in retail leasing or with free-standing, single tenant property. In this case, the tenant will pay for all the services, the taxes and insurance plus any systems maintenance while the owner will pay to maintain the roof, foundations and side-walls.

*Triple Net* (sometimes called absolute net) is also commonly used in retail leasing or with free standing, single tenant property. In this case the tenant will pay for all the services, the taxes and insurance plus any maintenance to the roof, foundations, side-walls, and all building systems.

*Common Area Maintenance* charges are sometimes added to the quoted rate and most often found in industrial parks and smaller strip retail centers. Quoted on a square foot basis, they refer to the cost of maintaining the parking lot, sidewalks, landscaping, signs or any other asset used in common by the tenants.

## Screening Potential Properties

Now it's time to make some screening calls. There are two objectives in prescreening property: decide which ones are worth the time to inspect and obtain written information and floor plans of the offering. Floor plans will help you see how well you might fit into a particular space or how it can be modified to meet your needs. Some web sites will have plans posted. You can also ask to have them faxed or emailed to you. Email is better for this purpose because it provides a better package, usually in color. Since your objective is to save time and effort, be prepared to leave a complete message when the party is not in. Ask for answers to all the questions you've ranked with a three and the highest priority two's, ask that the floor plans and fact sheets be sent to you. Be sure to ask that this information be sent right away, as that will be a good gauge of the responsiveness you can expect later.

This is especially important when soliciting the owners directly. Naturally, you will want to set an appointment to see the properties that get high marks.

Before you begin any site inspections, it is important to understand some basic concepts about commercial space. The first is that commercial space often needs to be modified to meet the needs of the tenant. Rarely do the existing conditions of space precisely meet the needs of the incoming tenant. Landlords anticipate this and are sometimes prepared to negotiate improvements for the tenant. How much you can successfully negotiate is a question of market conditions. Higher vacancy rates in a given market translate into more landlord contribution and conversely, very tight markets can put the responsibility to customize the space on the incoming tenant. Later we will discuss the space planning aspects of your transactions, but first we need to gain greater understanding of how commercial space is measured before we go out and start visiting available space.

# 6

## How Space is Measured

While all properties use the square foot as the basis of measurement, which parts of the property are included in the final calculations vary by building type. Gross square footage is most typically used with warehouses, industrial buildings and other stand-alone buildings, such as freestanding retail sites. Typically, the calculation will include the thickness of the sidewalls when measuring the total footprint of the site. When measuring multi-tenant warehouse, industrial and retail property, the inside measurement may be the most appropriate. This measurement will include 50% of the thickness of any demising walls.

Office buildings use substantially different calculations. The actual square footage that an office user may occupy is typically less than the amount upon which the rent is based. The square footage that you use exclusively is termed “usable square feet” and the amount upon which the rent is based is called “rentable square feet”. This is because office tenants pay their proportionate share for their use of building common areas. Common areas include lobbies, hallways, rest rooms, and service areas. The differential is expressed as a percentage known as a load or loss factor. When comparing properties, it’s a good idea to ask, “What is the load factor?” The higher the load factor the more of your space will be in the common areas and less inside the suite for your exclusive use. Occasionally, one may find a building that bases the rent upon the usable square footage. Since load factors can run 17 to 22 percent, this may represent real savings.

How does the load factor affect the economics of a lease transaction? The higher the load factor, the more space you need to rent in order to occupy an equal amount of usable space. When using a broker, ask for a lease analysis of both the rentable and the usable square footage.

There are standards by which commercial space is measured. In many areas, commercial property owners adhere to the Building Owners' and Manager's Association ("BOMA") standard. BOMA standards offer guidelines as to where and how to measure certain areas of the property. For example, to determine the measurement point on an exterior wall, the architect must determine the dominant portion of the wall. It could be the glass line or the wall surface depending upon the portion of the wall that comprises more than 50% of the wall's surface.

In multi-tenant buildings or on multi-tenant floors, hallways, maintenance areas, and rest rooms are apportioned to the tenants and are either included in the rentable area calculations or included in common area maintenance charges. Vertical penetrations such as stairwells, elevators and utility shafts are not included. These are just a few examples of the BOMA standards. Always ask how the space has been measured and the load factor to ensure you get the benefit of your bargain.

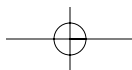
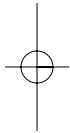
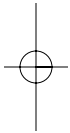
### **Space Configuration Effects Efficiency**

Comparing window and column spacing as it pertains to your needs can affect the efficiency of various office and R&D buildings. While there are many buildings that are effectively column free, often column spacing needs to be considered.

An office plan that calls for a high percentage of interior partition walls can integrate columns well into the plan, often affording striking design elements. Open plan users may find that too many columns can increase the cost of furniture systems and increase their square footage requirements. Window spacing has

a minimal effect on open plan office users. However, private office intensive users need to look closely at how window spacing affects office sizes, particularly where a mixture of office sizes is desired. The dividers between windows are referred to as mullions. The difference between a 4 foot 6 inch mullion spacing and 5 foot mullion can be dramatic. By example, a three windowed office would measure 13 feet 6 inches and 15 feet, respectively, resulting in a 9.3% difference in office size without a substantial benefit in usability.

Later we will discuss the use of a qualified architect to assist you in evaluating the efficiency of office locations under consideration.





# 7

## Touring the Property

Try to set up your inspection tours in groups of three to four buildings at a time, about 30 minutes per property plus travel time will be sufficient. By doing it this way you can more readily compare the features and benefits of the properties while the impressions are fresh in your mind. Even the best minds have difficulty remembering a large number of variables, by limiting the number of properties to 3-4 you will maintain clarity and separation between the properties in your mind. A camera helps too, as does taking notes.

Your objective during these tours will be to evaluate floor locations, views, physical characteristics, amenities, as well as the general character and quality of the building or site. Use a checklist to facilitate a thorough comparison of the buildings. This checklist can help you to evaluate non-economic aspects of the sites you visit. It also assists you in recalling the details of the properties and in narrowing down the list.

Here's a great checklist for you to use with your list of requirements. Bring one for each property you visit.

## TOUR SITE CHECKLIST

Location: \_\_\_\_\_

Key:

S = Satisfactory      P = Possible      U = Unsatisfactory

### 1. Building Considerations

S P U      Quality

S P U      Image

S P U      Security

S P U      Parking:  
Number of spaces \_\_\_\_\_

S P U      Elevator service:  
Passenger \_\_\_\_\_

Freight \_\_\_\_\_

### 2. Space Considerations

S P U      Efficiency (Load factor)

S P U      No. of floors: \_\_\_\_\_

S P U      Location in the building

S P U      Location of space on the floor

S P U      Views:  
North South East West

S P U      Columns:

Number \_\_\_\_\_

Size \_\_\_\_\_

Spacing \_\_\_\_\_

S P U Floor size

### **3. Location of the Project**

S P U Availability of public transportation

S P U Parkway access

S P U Neighborhood

S P U Image

S P U Quality services in the area: restaurants,  
health clubs, etc.

### **4. Lease Considerations**

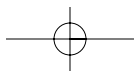
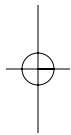
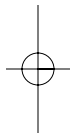
S P U Expansion space available

S P U Sublease

### **5. Ownership**

S P U Quality of ownership

S P U Quality of building management



# 8

## Creating a Proposal to Lease

Now that you have narrowed down your choices to one to three good potential sites, its time to start making your proposal or proposals, as the case may be. Because you are making non-binding proposals it may be all right for you to make more than one at a time. In many areas of the country it is an accepted practice to do so. You must be careful that the property owner does not incur significant expenses on your behalf or they may have recourse against you for those expenses if you fail to consummate a lease. I'd advise you not to go much beyond the first round of proposal responses or into multiple space planning sessions without informing the property owners that you are negotiating for more than one space. Creating competition in a softer market can work well in your favor, so letting the other side know that you have other options can garner some nice concessions. Just be careful and let the other party know that you are continuing to consider other locations.

Most often, proposals to lease commercial property take the form of a letter of intent. A letter of intent outlines the basic terms under which the parties would enter into a lease contract. After all the terms are settled, the credit-worthiness evaluated, and conditions satisfied, a lease draft is prepared. There are basically two approaches that brokers use in preparing letters of intent. The approach I favor is to make the proposal simple, that means I'll

try to gain agreement on the big issues first and set aside smaller issues to work out later in the lease negotiations. I prefer this strategy in negotiations because it relieves much of the inherent tension in the negotiations and makes agreement on the side issues easier to obtain. Some brokers prefer to issue a very lengthy letter of intent, covering every conceivable issue up front. I feel that this can dampen the spirit of the negotiations and often hit a hot button on a minor point. I've seen too many landlords vexed about minor side issues, and subsequently fail to see the merits of the proposal.

Office lease proposals are a good place to start, and as we proceed, I'll discuss the nuances that affect industrial and retail letters of intent.

## **The Letter of Intent Proposal**

01/01/2010

345 Office Tower Lane Associates  
123 Main Street  
Bigtown, USA 54321

RE: Proposal to Lease 345 Office Tower Lane

Dear Gentlemen:

We are pleased to submit to 345 Office Tower Lane Associates (the "Owner") the following proposal on behalf of The Best Tenant Company (the "Tenant") for the lease of certain premises in the 345 Office Tower Lane Building located at Bigtown, USA (the "Building").

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*We can see that this opening defines the parties and identifies the property. Always use the legal name of your business because the owner may respond differently if you are signing personally or as a corporation, LLP or LLC. Next, we will look at two ways we can describe the premises. Naturally, if we were making a proposal for the entire building, we would state that in a similar fashion.*

PREMISES: Suite No. 700 in the Building, on the 7th floor, containing approximately 4,250 feet of rentable area. Final square footage of the Premises will be determined by Owner or Owner's architect using BOMA standards and incorporated in the Lease.

Or

Approximately 4,250 square feet of rentable area located in the Building on the 7th floor, being a portion of the Northeast corner, to be further defined at space planning. Final square footage of the Premises will be determined by Owner or Owner's architect using BOMA standards and incorporated in the Lease.

*We would use this type of description when the Premises we desire are not yet demised or are a portion of a larger suite that can be made smaller.*

TERM: 5 years, commencing (insert date) being the Commencement Date and expiring (insert date).

*If the premises must be remodeled then we would insert the phrase "or upon substantial completion of the tenant improvements."*

*If there is a date by which you must absolutely occupy the premises, then add, "But in no case later than (date)."*

*Here are two ways to describe the rent for a fully serviced rental rate, which is mostly used in office leasing.*

RENT: Rent shall be calculated and paid on a rentable square foot basis payable monthly in advance commencing on the Commencement Date, subject to proration for a partial month, in accordance with the following schedule:

- Year 1: \$ annual full service gross rate.
- Year 2: \$ annual full service gross rate.
- Year 3: \$ annual full service gross rate.
- Year 4: \$ annual full service gross rate.
- Year 5: \$ annual full service gross rate.

Prepaid Rent in an amount equal to the first month's rent shall be paid upon execution of the Lease.

*Or you might simply write:*

RENT: Rent shall be paid monthly in advance in the amount of \$\_\_\_\_\_commencing on the Commencement Date, subject to proration for a partial month.

Prepaid Rent in an amount equal to the first month's rent shall be paid upon execution of the Lease.

*Owners expect that the first month's rent will be paid upon lease execution even if there are several months before the commencement date.*

*Negotiation Tip: If you are leasing more space than you need initially, you may be able to structure the rent so that it starts off lower and graduates. Or, you might ask that the first*



*year's rent be calculated only on the portion of the space that you will be using initially.*

#### INCREASES IN OPERATING EXPENSES:

Tenant will maintain the premises and all the portions thereof not the responsibility of the Owner. Tenant shall reimburse Owner for its prorata share of increases in Building Operating Expenses and Taxes over the Base Year.

*Tenants are required to pay for any increases in the cost of operating the building after the first year of the lease. This is more fully explained later. The first year of the lease is called the base year, because is it the year to which all future operating expense budgets are compared. Base years are most often calendar years, especially in multi-tenant properties.*

*If you've been quoted an industrial gross rental rate (or single net) you would write something like this.*

#### GROSS RENT:

Rent shall be calculated and paid on a gross square foot basis payable monthly in advance commencing on the Commencement Date, subject to proration for a partial month, in accordance with the following schedule:

Year 1: \$ Monthly gross rate.  
Year 2: \$ Monthly gross rate.  
Year 3: \$ Monthly gross rate.  
Year 4: \$ Monthly gross rate.  
Year 5: \$ Monthly gross rate.

Prepaid Rent in an amount equal to the first month's rent shall be paid upon execution of the Lease. *(If you've been quoted a common area maintenance charge or percentage rent, include that here.)*

Or

Rent shall be paid monthly in advance in the amount of \$X.XX commencing on the Commencement Date, subject to proration for a partial month.

Tenant shall pay for its use of all utilities and janitorial services supplied to the Premises. Tenant shall reimburse Owner for its prorata share of increases of Real Property Taxes and Insurance over the Tax Year \_\_\_ - \_\_\_ .

*In most areas, property taxes are paid on a fiscal year July 1 to June 30. Base years are most often calendar years, especially in multi-tenant property. If you're leasing space in a building with one or two tenants, you might be able to negotiate for the base year increases to be paid on the anniversary dates of your lease.*

*Since industrial property is almost always quoted monthly, I've written it that way for you here. Also note that it refers to gross square feet, which, is measured differently than rentable square feet. Since some office buildings can also quote the rent on a gross rent basis, you need to ask if the space has a load factor. The load factor is the portion of a floor or building that tenants use in common with other tenants. If the answer is yes, then modify this paragraph to read "rentable square foot basis".*

*If the property is a multi-tenant property you will need to define the owner's obligations related to the common areas. That might be stated this way.*

#### **BUILDING MAINTENANCE AND REPAIRS:**

Owner shall maintain and repair the common areas of the building, roofs, exterior walls and foundations of the building and provide utility and janitorial service to the building, the cost of which is included in Building Operating Expenses. Tenant will maintain the premises and all the por-

tions thereof not the responsibility of the Owner. Tenant shall reimburse Owner for its prorata share of increases in any Building Operating Expenses not paid directly by Tenant, over the Base Year\_\_.

*Next we'll look at how we might write a rent proposal for a triple net or modified net lease transaction. Again if there were no load factor, you would typically use the gross square footage description.*

NET RENT: Rent shall be calculated and paid on a gross square foot basis payable monthly in advance commencing on the Commencement Date, subject to proration for a partial month, in accordance with the following schedule:

- Year 1: \$ Monthly net rate.
- Year 2: \$ Monthly net rate.
- Year 3: \$ Monthly net rate.
- Year 4: \$ Monthly net rate.
- Year 5: \$ Monthly net rate.

*(If you've been quoted a common area maintenance charge or percentage rent, include that here.)*

Prepaid Rent in an amount equal to the first month's rent shall be paid upon execution of the Lease.

Or

Net Rent shall be paid monthly in advance in the amount of \$ \_\_\_\_\_ commencing on the Commencement Date, subject to proration for a partial month. Prepaid Rent in an amount equal to the first month's rent shall be paid upon execution of the Lease.

Tenant shall pay for its use of all utilities and janitorial services supplied to the Premises. Tenant shall reimburse Owner for its prorata share of increases of Real Property Taxes and Insurance(s) over the Tax Year \_\_\_ - \_\_\_.

*In most retail transactions, which commonly use net rents, the onus is on the tenant to make its own improvements or install fixtures. Therefore, it is customary to start the lease but delay the start of the rent for a time to allow the tenant to do its work. We then want to abate the rent and delay the reimbursement of expenses to the owner for the fixturization period. It might look like this:*

Tenant shall not be required to pay Rent for XX days after the Commencement Date.

Tenant shall reimburse Owner for its prorata share of Building Operating Expenses commencing XX days from delivery of the Premises ready for commencement of Tenant's work of improvement to the Premises, the Lease Commencement Date.

Tenant shall reimburse Owner for its prorata share of Real Property Taxes, commencing XX days from delivery of the Premises ready for commencement of Tenant's work of improvement to the Premises, the Lease Commencement Date.

*In the true triple net lease, the tenant assumes the obligation to maintain all aspects of the property. However, you will sometimes find that a rent is quoted triple net but the owner is responsible for the basic building structure. One tip off is if the building has more than one tenant. This is actually a modified net lease and you would include something like this in your proposal:*

#### REPAIRS, MAINTENANCE and UTILITIES:

Owner shall maintain and repair the common areas of the building, roofs, exterior walls and foundations of the building.

Tenant will maintain its share of the Premises and all the portions thereof not the responsibility of Owner, and pay for all utilities supplied to the Premises not included in the Building Operating Expenses.

*A final note about rents: There are as many ways to parse rent as there are components of rent, so use these paragraphs to guide you as your situation dictates.*

*If there are free rent periods offered as an inducement to lease you could write it this way:*

#### RENT ABATEMENT:

Tenant shall not be required to pay Rent for XX months after the Commencement Date.

*Negotiation tip: The owner might be more willing to grant rent abatement if you propose 1/2 rent for a longer time rather than free rent for a shorter period. Free rent can also be spread out over the term, which is often more palatable to owners. The next item is the Tenant Improvements, keep this simple.*

#### TENANT IMPROVEMENTS:

Owner shall provide tenant improvements in accordance with a mutually acceptable space plan, which plan shall be provided at Owner's sole expense. It is contemplated that the Tenant's improvements shall include the following items of improvement:  
*(Here you would list the modifications you want)*

*Here we are asking the owner to provide the preliminary space planning services. If you are providing your own space planner, it is sometimes possible to negotiate for payment of your architect by the owner. Typically, this would occur when space-planning services are already being offered by the owner to attract tenants. It is worth a try.*

### **The Tenant Improvement Allowance**

*Some buildings offer a Tenant Improvement Allowance. This is stated as a number of dollars per square foot. These can range from enough to provide paint and carpet to a full build-out.*

*Since office buildings quote the rent on a rentable basis, it makes sense that the Tenant Improvement Allowance is also quoted that way. But often it is not, particularly in new construction, because the common areas have to be developed by the owner and a portion of the allowance is used for that. Ask how the Tenant Improvement Allowance is quoted to be sure of what you are getting. If the allowance or other tenant improvement package offered is less than you need to construct your premises then ask that the excess improvements be amortized over the term of the lease. This is effectively a loan to you and will increase your monthly rent and will normally bear interest at the owner's cost of funds or slightly more.*

*Be aware that if the owner is doing the work of improvement based upon an allowance, they will be taking some back for supervision of that task on your behalf, this can range from 5% to 15% and is negotiable. Ask if there will be a supervision charge when you are quoted an allowance and negotiate this amount down. Architectural and engineering costs will be also taken from the allowance and can run from \$1.50 to \$2.50 per square foot.*

*Be aware that if you are offered a reimbursement for tenant improvements provided by you, it could cause a taxable event. Consult a tax advisor before agreeing to any cash allowance that comes as a reimbursement.*

*The Tenant improvement paragraph might be proposed like this:*

TENANT IMPROVEMENTS:

Owner shall provide a tenant improvement allowance of \$25.00 per rentable (or usable) square foot and shall construct the Premises in accordance with a mutually acceptable space plan, which plan shall be provided at Owner's sole expense. It is contemplated that the Tenant's improvements shall include the following items of improvement:

*(Here you would list the improvements you want)*

Supervision fees charged by Owner shall be limited to X% of the cost of improvement work.

*Tip: If you've been provided with a floor plan of existing conditions, mark it up and include it with your proposal.*

*A final note on tenant improvements: Sometimes you will hear the term "Tenant Work Letter", most often in conjunction with new developments. This refers to a list of building standard component parts that are used to develop the premises for the prospective tenant. Typically, this is allocated as a certain number of each item for each 100 to 150 square feet of space leased. By example: a certain number of lineal feet of wall per 100 square feet, one electrical outlet per 150 square feet, one phone outlet, one interior door, so many sprinkler heads and so on. While this can be confusing, the solution is quite simple. Proceed to space planning, which will be discussed in-depth later in the book, and have the architect tell you if the "work letter" is sufficient to create the suite you desire. If not, you're back to the negotiating table for what you want.*

*Next you speak about your use. General office is easy, retail and industrial uses can be more of a concern to owners. Retail proposals need to be accompanied with your business plan. Industrial use concerns are more centered on the use of hazardous materials so put in an accurate description of your use.*

#### USE OF THE PREMISES:

The Premises shall be used as general office space and other legally permitted uses as more particularly set forth in the Lease.

*If you use hazardous materials, it's important to discuss that up front to avoid wasting everyone's time. In industrial space you'll want assurances that the space is clean before occupancy. Be sure to ask the owner for a complete written disclosure about prior uses of the premises.*

#### HAZARDOUS MATERIALS:

Tenant's use or storage of Hazardous Materials as defined by local, state or federal law will be subject to the prior written consent of Owner. Any such Hazardous Materials must be brought upon, kept and used in strict compliance with all such laws. Owner will represent that neither the Premises nor the Building contain Hazardous Materials to the best of its current knowledge as of the Commencement Date.

*Most tenants are concerned about expansion rights so they can avoid moving if they outgrow the space. Owners are reluctant to grant any options since options never serve the owner's interests. Options to expand or renew are definitely considered con-*



*cessions by property owners. I suggest you ask for what you want but expect that the owner's response will attempt to water down your rights as much as possible. In tight space markets, option concessions tend to go away.*

#### EXPANSION OPTIONS:

Tenant shall have the right to \_\_\_\_\_ rentable square feet of contiguous expansion space commencing on the \_\_\_\_\_ month of the lease term, and upon \_\_\_\_\_ days written notice by Tenant to Owner. The rate for the subject expansion shall be the unescalated rent set forth in the rent schedule contained herein in the section titled RENT. Owner shall provide a tenant improvement allowance sufficient to construct the expansion premises to a condition substantially similar to the original premises.

*Here we have set out the amount of space we want; when we want it; how much notice we will give before we take it; what the rent will be and in what condition it will be delivered.*

*Taking more space than you need initially is another way tenants deal with planned growth of their business. If you use this method you will certainly want to ensure that you have the right to sublease a portion of the space. It might be proposed this way:*

#### ASSIGNMENT AND SUBLEASE:

Assignment or Sublease of any interest in the Lease or the Premises by Tenant will be subject to Owner's prior written reasonable consent pursuant to standards employed by Owner on a consistent basis.

All proceeds realized from an assignment or sub-

lease of the Premises in excess of sums due under the Lease will be divided equally between Owner and Tenant.

*You can negotiate for all or some portion of any excess rent to flow to you if market rents rise later in the term. Generally, the more the owner has contributed in tenant improvements, the more they will want to share in any upside. The excess or bonus rent is usually determined by deducting any costs incurred by the tenant in securing a subtenant.*

Here's a straightforward way of obtaining the right to renew the lease without having to guess at the future rental rate.

#### EXTENSION OPTION:

The Lease will provide that Tenant will be granted one option to extend the Lease term for a successive period of XX years. The rent for the extension term shall be (a fixed amount).

Or

The rent for the extension term shall be increased by an amount equal to the increase in the CPI index, as more particularly set forth in the Lease.

Or

The rent for the extension term shall be \_\_\_% of the then fair market value, as more particularly set forth in the Lease.

*As you can see, you can choose to negotiate for a fixed rate increase in the renewal or a CPI index adjustment, or a fair market value adjustment. The clause would be modified accordingly. In the section of the book that covers lease clauses we will discuss renewal options further.*

**SECURITY DEPOSIT:**

An amount equal to the last month's rent shall be paid as a security deposit upon execution of the Lease.

*Unless you represent a major corporation with very high credit, expect that you will always be required to provide a security deposit. Security is important to owners, especially when they are providing a significant amount of tenant improvement dollars to secure a tenant. You may be faced with a response from an owner for substantially more security for the lease depending on your business history, credit and profitability. Some alternatives to cash are standby letters of credit, or performance bond certificates. Performance Bond Certificates allow the tenant to draw interest on cash deposits at the bank, while allowing the owner to claim all or part of the deposit in the event of a default. Security deposits for commercial leases rarely pay interest to the tenant, and unless you are required to put up an unusually high amount, do not expect interest on your security deposit. Some owners will require a personal guaranty from the principal owners of the company. If your business is solid, profitable and has a good history, a personal guaranty may not be too painful for you; but it can put your personal assets at risk in the event you default on the lease. Be careful about agreeing to a personal guaranty and consult your attorney. If you are required to put up a large deposit in any form, attempt to have it reduced as the lease term progresses or have the requirement eliminated upon reaching a certain profitability or net worth.*

*Always ask the owner to disclose any known defects. You might write it this way:*

**DISCLOSURES BY OWNER:**

Owner shall disclose to tenant the nature or extent of toxic wastes or hazardous materials as defined

by federal, state or local law, or other undesirable substances which may be present in the Project (or building). All matters related to the physical condition of the Project, including but not limited to soil conditions, the structural integrity of the improvements, and the presence or absence of fungi or wood destroying organisms in the Project. The accuracy or completeness of square footage figures; the possibility that leases, options or other documents or agreements exist which affect or encumber the Project and, which have not otherwise been provided, shall be disclosed by Owner.

*For the proposal to be construed as non-binding, it is essential that it be clearly stated that there are additional matters that bear further negotiation. It is not enough to just say this is non-binding. It might be written this way:*

**NON-BINDING EFFECT:**

The parties acknowledge that the foregoing proposal represents their agreement at this stage in the negotiations, subject to modification and based on further negotiations, concerning other material lease terms.

*Next you must allow time for the owner's response and time to review your financial credit information. So a good closing paragraph to the letter might read like this:*

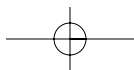
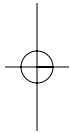
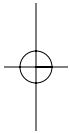
The preceding proposal is contingent upon Owner's and Tenant's mutual approval of the final Lease agreement, conceptual space plan, and Owner's approval of the credit worthiness of Tenant. In order to permit Owner to adequately evaluate Tenant's credit worthiness, Tenant agrees to furnish Owner with its current financial statement, banking and credit references, and the name

and address of Tenant's preceding Lessor such information to be provided within XX days after execution by both parties. Information will be retained on a confidential basis except to the extent that Owner discloses the same to its lenders.

Please sign and return a copy of this letter to us by \_\_\_\_\_, 20\_\_\_. If your acceptance of this letter is not received by such date, the letter shall terminate and be of no further force and effect.

*End the letter with a signature block that allows for the owner to accept the proposal.*

*This proposal will get you well into the lease negotiations. Once the proposal stage is complete, you will be provided with a draft lease for you and your legal counsel to review and fine tune into a contract that accurately defines your agreement. Please do not construe the information provided here as legal advice or a substitute for legal advice. This is intended to be a primer in leasing and cannot possibly contemplate all the particulars of any actual transaction.*



# 9

## Subleasing Space

Sometimes you will encounter a space for sublease. Or, if you need to move quickly, look for a sublease as one possible solution. You won't usually get as long a term as you might with a direct lease, but if your business really takes off, you could outgrow the space very quickly anyway.

One of the big advantages of sublease space is that it is often available at below market rates and therefore more affordable.

Generally speaking, the shorter the sublease term, the lower the rate. Be aware that in a sublease situation, you may not be able to stay in the space beyond the expiration of the term, or if you can, you may be subject to "rate shock" at lease expiration.

The majority of subleases provide less opportunity for customized tenant improvements because sublessors try to limit their cash outlay to minor cosmetic improvements. One of the most serious drawbacks of a sublease, is the possibility that the sublessor stops paying the rent. In which case, you may also become subject to the default and the consequences included in such an action. You can attempt to overcome this problem, after striking an economic agreement with the sublessor, by obtaining a "novation" (new lease) of the lease from the Master Lessor. With a novation you might have some bargaining power for extra tenant improvement dollars and a commitment for a longer term. Another option is to ask your attorney to provide a non-disturbance clause in the lease when you begin negotiating the final contract.

Ask to review the sublease provisions of the master lease as soon as possible after identifying a potential sublet. You'll need to fully understand the Master Lessor's rights as well as the sublessor's limitations in offering the premises for sublease to ensure a successful transaction. In particular, you need to know if the Master Lessor has the right to terminate the tenant's lease if they apply to the Master Lessor for consent to sublease. This could kill your chances of subleasing the space, so get this issue cleared up right away. If the Master Lessor is taking the space back you might find yourself negotiating a new lease with the owner. If the sublease was at below-market rates, expect the owner to offer the space to you at market price.

The fundamental difference between a sublet and an assignment of a lease is that a sublease is for less than either the entire of the premises or the term. In other words, the sublessor retains either the right of occupancy for a part of the space or the right to re-enter the premises prior to the lease expiration. Another aspect of an assignment is that it puts the (sub) tenant into a direct relationship with the landlord, not the sublessor, as in the case of a sublet. Sometimes the Master Lessor has the right to adjust the rent to market value if the space is sublet or assigned, so be on the look out for this when you review the master lease, however, if the conditions are right, subleasing may be a good answer to your space requirements.

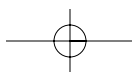
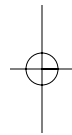
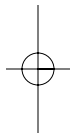
The basics of a sublease proposal are the same as a lease proposal but you will need an extra clause.

**SUBLEASE:** This transaction will be a Sublease. A copy of the Master Lease will be delivered to Tenant within \_\_\_\_\_ days following execution of this Letter. This proposal is subject to Master Lessor's approval as set forth in said Master Lease and to Tenant's compliance with the terms thereof. Tenant shall not contact Master Lessor without Sublessor's



prior written reasonable consent.

*Here you are asking to look at the master lease because you will be subject to its terms. The Master Lessor must approve your taking the premises.*



# 10

## Using a Request for Proposal

Now that we have a good understanding of the various aspects of a letter of intent proposal, we can take a look at the Request for Proposal or RFP. Using an RFP is for larger tenants in markets that favor leasing concessions by owners to prospective tenants. If that is your position then by all means use an RFP because it is an excellent negotiation tool. When you make the first bid on a property with a standard letter of intent, what typically follows is a counter offer, which you would then accept or respond to again. Often this is as far as the negotiations go and acceptable terms are reached. When you begin with an RFP, you are essentially asking the owners to come off their asking rent and other terms. Then you respond, they counter, you counter and you've made a better deal for yourself because of the extra round of proposals. Since you now have a good understanding of the issues surrounding a letter of intent, we can quickly look at a sample RFP to see how it might be constructed.

01/01/2010

*345 Office Tower Lane Associates  
123 Main Street  
Bigtown, USA 54321*

RE: Request For Proposal to Lease 345 Office Tower Lane

Dear Gentlemen:

We are pleased to submit to 345 Office Tower Lane Associates (the Owner ) the following Request For Proposal on behalf of The Best Tenant Company, Inc. (the Tenant) for the lease of certain premises in the 345 Office Tower Lane Building located in Bigtown, USA (the Building). Please provide a leasing proposal that adequately addresses the following leasing terms and conditions.

**PREMISES:** Approximately 4,000 feet of usable area located in the Building on the 7th floor. Please provide a sample layout of the location on the floor and detail the standards used to measure the premises and the load factor to be used in calculating the rentable area of the premises.

**TERM:** Please make your proposal for a 5-year, a 7-year and a 10-year term.

**RENT:** Please propose your rent schedule for each of the lease terms outlined above, including any proposed prepaid rent payable upon execution of the lease. Include a list of all expenses payable by tenant not included in the rent.

**BASE YEAR:** Please propose the base year for reimbursement of prorata share of increases in Operating Expenses and Insurance. Please indicate the base year for taxes.

**REPAIRS AND MAINTENANCE; UTILITIES:** Please state the Owner's responsibilities regarding the maintenance and repair of the common areas of the Building, roofs, exterior walls and foun-

dations of the Building and obligation to provide utility and janitorial service to the portions of the Building not in the Premises.

**RENT ABATEMENT:** Please propose any rent abatement offered as an inducement to lease the premises.

**TENANT IMPROVEMENTS:** Owner shall provide tenant improvements in accordance with a mutually acceptable space plan, which plan shall be provided at Owner's sole expense. It is contemplated that the tenant's improvements shall include the following items of improvement: (List your desired improvements here or you may suggest a tenant improvement allowance.)

**OVER STANDARD TENANT IMPROVEMENTS:** Please outline any over standard tenant improvements you are offering as an inducement to lease.

**USE OF THE PREMISES:** Provide your proposed use.

**EXPANSION OPTIONS:** Tenant requires approximately XX square feet of additional space for its growth. Please outline how you intend to provide for contiguous expansion space, the commencement date for such expansion space; the number of days of written notice by Tenant to Owner to exercise expansion rights; the rate for the subject expansion; and Owner provided tenant improvement allowance or Tenant Improvement work.

**EXTENSION OPTION:** Please indicate any option periods for successive years, the rent for any extension term; and the notice period for exercise of option.

**ASSIGNMENT AND SUBLEASE:** Transfer or hypothecation of any interest in the Lease or the Premises by Tenant will be subject to Owner's prior written reasonable consent pursuant to standards employed by Owner on a consistent basis. Please outline how any proceeds realized from an assignment or sublease of the Premises in excess of sums due under the lease will be divided between Owner and Tenant.

**SECURITY DEPOSIT:** Please indicate your minimum security deposit requirements.

**DISCLOSURES:** Owner shall disclose any and all material facts regarding any and all conditions that might influence Tenant's decision to lease space in the Building.

We look forward to a written response to this request, no later than (date), and to a mutually satisfactory tenancy in the building.

*Requests for Proposal are powerful instruments in a negotiation because the tone of the negotiations is set with the owner pursuing your tenancy. Not all owners will respond to RFP's and some owners will encourage you to make your offer first. If you send out several RFP's and most owners respond, use those responses to either encourage the reluctant owner to come forth with a proposal, or if you really want a particular space, to frame your own offer.*

# 11

## Americans with Disabilities Act

The Americans with Disabilities Act or ADA affects office, industrial and retail space alike. If you are dealing with a brand new development or space that is undergoing very substantial renovation, you will have very few issues with which to concern yourself regarding ADA because the building codes will ensure compliance. The older the property, the more likely you are to encounter requirements to comply with the ADA when undertaking renovations of the property. The more the owner is involved with the construction, the more likely it will be the owners issue. Be extra careful when dealing with an owner that requires the tenant to make their own improvements or offers a reimbursement for tenant provided improvements. You could find yourself having to upgrade common areas as a result of making improvements to your premises.

ADA rules affect all areas of the property from the entry through the common areas to the premises. Applying for a building permit will automatically trigger ADA compliance. What level of compliance is a matter of interpretation by the local governing authority. Many authorities will grant some relief to full compliance when the total of the improvements is below a certain monetary threshold. Two important things to remember here are; that this exemption may or may not be granted as a hardship; second is that the prior issuance of building permits may have used some or all of the threshold amount and building departments do

keep track of prior permits.

Do not attempt to tackle ADA compliance issues without the help of a professional. If you are employing a space-planning architect, it will be their responsibility to keep you informed about this subject. If you are going to be responsible for the construction work, you are well advised to seek the help of an expert in ADA compliance. At minimum you must go to the planning department and ask that the building file be reviewed and that a building inspector visit the site before you sign the lease.

When negotiating your tenant improvements try to limit your exposure to ADA compliance to the premises and put the compliance of the remaining portion of the building on the owner whenever possible. ADA compliance is a matter of “*interprétation du jour*” so do not rely upon the representations of the owner or owner’s agent in this matter when dealing with any property, except brand new construction. An error in judgment regarding ADA compliance can be very costly, so do not skimp on professional advice when dealing with this issue.



# 12

## About Retail Lease Proposals

In considering a retail location, traffic and walk by counts are vital to the success of your business. Make sure these representations are put into the lease. If you have been quoted specific numbers of these items, be sure to try to negotiate for a reduction in your rent if the actual numbers fall below the numbers you've been quoted. This can happen when an anchor tenant in a center goes dark unexpectedly and your business volume dries up. It can happen that an anchor tenant closes a location, but continues to pay on the location while exercising its non-competition rights, preventing the owner from replacing the anchor tenant.

When you are proposing your lease term, think about the best month for your lease to terminate. If your business thrives during the year-end holiday season and you open your business before the holidays, you may want the lease to end in January or February, rather than an annual anniversary of the commencement date.

Be aware that some shopping centers may carry late opening penalties so you will want to be sure that you can complete your work of improvement and install your fixtures and inventory in time to meet your opening date obligation. Conversely, taking delivery on inventory or fixtures before you have completed the lease transaction will prejudice your bargaining position. Be

careful about revealing information about these kinds of commitments to the owner when negotiating your lease.

Within the operating expense budgets for shopping centers you are likely to find that you are paying for promotion and media fees. Be sure that these are reasonable and will benefit your business. You may want to try to have some limits put upon how much these can be increased annually or you might find that a weak center is spending more than you can afford to try to save the center if business falls off.

Take a close look at how your neighbors are using utilities in the center and research whether or not you are sharing utility meters with high demand users. A video store sharing a water meter with a hair or dog-grooming salon is not fair and adjustments need to be negotiated if separate meters are not possible.

In older strip centers, it is vital that you have the HVAC systems inspected if you are responsible for maintaining the units. Be sure to limit your responsibility to maintenance and minor repairs only. Put limits on how much you will pay for a single repair or an expense stop for annual repairs. Replacement of the units should always be the duty of the owner.

Operating a business next to a business that may be morally objectionable such as an adult arcade can be a business killer. Have your attorney draft language to protect you from the owner leasing to such uses.

Do not forget to negotiate for the signage rights you want, and take the time to ensure that the type, size and quality of signs you want are permitted in the center and in the community.

# 13

## Space Planning

Space planning usually occurs after an initial proposal has been tendered, although sometimes it will be delayed until the major deal points have been agreed upon and your credit reviewed. The proposals are conditioned upon reaching a mutually satisfactory space plan and a review of the associated costs.

Whether you will need space planning services or not will depend on the size of your transaction and the need to customize the location to meet your needs. If there will be construction, no matter how seemingly simple, the services of a qualified professional are essential, not optional. Because all construction requires building permits, and permits trigger inspections, it is possible that inspections could uncover required code corrections. Using a qualified architect will alert you to potential problems before you sign a lease. If you're in a tight market or responsible for the work of improvement for any reason, you do not want any surprises. Avoid unhappy surprises and use a qualified space planner when modifications are needed.

Retail tenants are usually expected to provide their own interior improvements and therefore they are expected to provide the designs for the landlord's approval. Industrial and warehouse tenants have less use for space planning, except when there is a large component of office space to be developed in the space such as in a research and development property (R&D).

Larger office buildings often have space planners on retainer and offer their services to prospective tenants. Some will require that prospective tenants use the building architect.

A commercial tenant requiring a substantial amount of office space is well advised to consider retaining his or her own architect. While building owners typically retain their own architects as an accommodation to prospective tenants, there are several good reasons to hire your own architect. First, due to the complex nature of today's office environment, including furniture systems, filing systems, computers and peripherals, your architect will understand your needs best. Additionally, as you narrow down your selection of properties, your architect is your best sounding board for efficiency, functionality and work flow.

Because building owners have budgeted for architect design services, in a softer market you can be successful in negotiating to have your architect's fees paid as part of the tenant's improvement allowance.

When I've seen problems arise in transactions that are centered around space planning issues, it's been because the architect selected to do the space planning has not been currently working with commercial property. Commercial interior space planning is relatively easy and preliminary plans can be readily done by any qualified architect. Where the problems arise is in underestimating the cost of commercial renovations, lack of knowledge about code issues and consequently using an approach to the job that results in over-designing the space. Stick with a specialist here and you'll avoid problems.

## The Space Planning Process

Again, space planning is usually done after the basic business terms are aligned and is normally a two to three week process to arrive at a satisfactory preliminary plan. This means that a set of drawings have been developed and reviewed and are suitable for obtaining preliminary estimates from the contractors. Depending upon the scope of work, allow about one to two weeks to complete the estimating. At the first meeting with the architect you will be conveying your requirements and desires. The architect develops the first plan, submits it to both the landlord and you for review and comments, and then makes the required revisions.

Another important step will be a technical review of the building being considered. This review is actually in two parts, the first of which will have been completed during the tours of the most qualified sites. At this time, you will need to review conditions in the building, which can affect the functional viability of the space (e.g. air conditioning, elevator size).

An architect or space planner should complete the second, and more thorough step of the technical review. If you are using the building's architect, be sure to ask if there are code or functional issues with the building that might increase costs. Some areas of concern include potential problems with the interior construction, the life safety systems, the presence of asbestos, compliance with the Americans with Disabilities Act (ADA), energy conservation compliance, or other issues critical to the quality of your occupancy.

Here is another checklist for you to use with an architect. Be sure to discuss these items to avoid unhappy surprises later.

## ARCHITECTURAL REVIEW CHECKLIST

Review interior standards for sufficiency and quality.

- Partitions
- Doors
- Closets
- Floor Coverings
- Lighting Fixtures
- Wall Finishes
- Ceiling Tiles
- Electrical Switches
- Electrical Outlets
- Telephone Outlets
- H.V.A.C.
- Window Treatments
- Life Safety Systems
- Drinking Fountains

Substantiate the dollar value of tenant work letter.

Review the policy on credits and substitutions of materials

Estimate and review costs of over standard tenant improvements.

## REVIEW BUILDING SYSTEMS

### H.V.A.C.

- Machines for compression and pumping systems
- Heat recovery and heat exchange
- Air handling equipment, location and space
- Number of zones per floor
- Supplemental cooling
- After-hours procedures

### Power, Data, and Telecommunications

- Service capacity
- Distribution method
- Emergency generation
- Power in watts/square foot
- Lighting in watts/square foot
- Telephone switching equipment
- Satellite communications or microwave link
- Shared tenant services

### Basic passenger service

- Rentable square foot per elevator
- Passenger weight capacity
- Lighting controls
- Service intervals

Tenant lighting services

Switching capabilities

Fixture and lens type

Fixture and floor area ratio

Lighting controls

Freight

Dock ramps and levelers

Freight elevator specifications

Ceiling and floor systems

Suspended ceiling components

Raised floor access potential

Poke-through potential

Services conveyed through ceiling or floor spaces

Life safety and Security

Strobes

Sprinklers

Detection

Communication system

Loading dock security

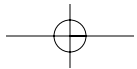
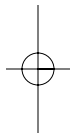
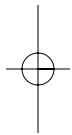
Building management systems

Building management systems and central controls

Master H.V.A.C. controls



During the time space planning is going forward, it is very likely you will be reviewing the legal aspects of the lease contract. Most often the lease is prepared by the building owner and given to you for review and comment. You can easily review the basic business points to see if they are in conformance with your agreement at this stage of the negotiations. However, lease contracts are highly technical and cover a wide range of issues from your rights to sub-lease the space to what will happen if the building is seriously damaged or destroyed. Only a qualified attorney can review your particular contract with respect to these issues. What follows here is designed to alert you to number of aspects that commonly appear in leases. It is not and cannot be a comprehensive review of the lease you may be asked to sign. It will be useful to you to understand these basics when discussing the proposed changes to the lease that your attorney will recommend.



# 14

## Analysis of Responses to Proposals

After the owner has responded to your initial proposal, it is time to analyze all the major points of the response. If you have made more than one proposal there are certain elements that need to be compared. These items might include:

Rent rate calculated on the basis of rentable square feet and the rental rate calculated on the basis of useable square feet. This is arrived at by subtracting the load factor from the rentable square footage.

Compare the effective rent, which is nothing more than averaging all the years of the rent and factoring in any free rent periods. This is important because your responses may use different rent structures. By reducing this to the average rent per year, per foot, you can easily see which proposal has the better economics.

Different properties have differing operating expense histories and it is a good idea to ask for a 3-year history of the operating expenses. Well run buildings have very stable operating expense histories and unless there's been a spike in energy costs, janitorial contract re-negotiations, an insurance crisis, or snow removal, the expenses should be fairly even.

Next you will want to compare:

Tenant improvements offered by the owner

The cost of any improvements you are required to provide

Length of term, options to expand, extend or to cancel

Timing to delivery

Overall suitability

# 15

## Lease Negotiation to Lease Execution

The negotiation of the lease document is one of the most crucial steps in the relocation process. Because there are almost as many lease contracts as there are buildings to lease, it is impractical and inadvisable to sign a lease contract without a review by qualified legal counsel. Some leases are preprinted forms, which may be suitable for many transactions, but most are customized contracts developed by legal counsel for the owner. Preprinted form leases can run from two legal size pages to twelve pages, plus addenda and exhibits. Custom leases, especially for high-rise office buildings, large retail or industrial sites can easily run 50 to 80 pages. All leases define the business terms, which is the smallest portion of the lease. The balance of the lease seeks to contemplate possible future events and prepares for these events.

You will need to work closely with your legal counsel in negotiating the final terms of the lease, including the language of the lease, the economics of the lease, all references to the interior construction and other contractual elements. Make sure that all the terms of the proposals are incorporated into the lease and reviewed every step of the way. Next we will develop a basic understanding of how to deal with some of the more common clauses in the contract.

## The Flexible Lease

Commercial property leases are a diverse set of instruments designed to meet the needs of office, industrial/warehouse and retail property owners and tenants. Leasing property provides a pragmatic solution to the expansion and contraction of business real estate users, allowing flexibility for growth or consolidation. For this reason many businesses prefer leasing to the limitations of ownership. Leases for more than one year must be in writing to be valid in most states. As a practical matter, make all your leases in writing regardless of how short the term. Remember that the person with whom you are dealing today, may be gone tomorrow.

There are many variations of the commercial lease contract. The spectrum ranges from the fully serviced gross lease to the absolute net lease or the triple net lease. Previously we discussed that the term NET often causes confusion. Again a simple way to think of NET is to substitute the word NOT for NET. In other words, some services or expenses are payable directly by the tenant and are not included in the rent. The type of lease to be used is largely determined by the level of control over the use of the property assumed by the commercial tenant or retained by the property owner.

To better understand this, let's look first at the fully serviced gross lease. Most commonly used in multi-tenant office buildings, the fully serviced gross lease is used when the property owner provides a full range of building services to the tenant. A full range of services would typically include all utilities, janitorial, systems maintenance or replacement, common area and exterior services and upgrades, security, management and reserves. Taxes and insurance are also included in the rent. The underlying concept for this type of lease is to facilitate the property owner's or manager's need to exercise a high degree of control over the operation of the property. Multi-tenant buildings and

complexes need daily supervision of operations. Ironically, and to make matters more confusing, an absolute net lease can be used to meet the same goal for owners. The primary difference is the accounting method for the payment of the services by the tenant.

At the other end of the spectrum, we find buildings requiring little or no operation by the owner. Most often this would be a single tenant building or complex, where the tenant arranges and pays directly for its services and maintenance. Warehouses, industrial, and freestanding retail buildings are common examples. The absolute net lease is, practically speaking, constructive ownership for a period of years. The tenant pays all expenses for the operation, maintenance, taxes and insurance for the property on behalf of the owner. When this type of lease is for an exceptionally long term, the tenant may be required to upgrade the property to conform to newly implemented governmental regulations including seismic strengthening or asbestos abatement.

Along the spectrum from the fully serviced gross lease to the absolute net lease, there are a whole range of lease forms based upon who pays for various expenses such as real estate taxes, insurance, maintenance of the roof, side walls, and building systems.

### **Limitations of Month to Month Tenancy**

Long-term leases offer protections and perks not found in month to month tenancies. Suppose you are in a relatively soft market, where owners are offering some free rent periods and tenant improvements as an inducement to lease. These would simply not be available to the month to month tenant. If you take a month to month tenancy and end up staying for several years, you've missed these valuable concessions. Month to month tenants can also have the rent increased with a thirty-day notice. Sometimes when markets turn from a tenant's market to an owner's market, rents rise rapidly and spectacularly. A longer-

term lease will provide you protection against skyrocketing rents until the lease expires. Since it is costly to move into a commercial space, after moving in, you could find yourself being given an ultimatum to sign a long-term agreement favorable to the owner or given the alternative to vacate. Month to month tenants can be asked to move out on just 30 days notice unless a longer notice period is first negotiated.



# 16

## Common Lease Clauses

### The Parties to the Lease

Your lease will start off with the basic business points, either in an outline form or using a fill-in-the-blanks system as with form leases. We do need to know some of the nuances of these. The lease will describe the legal entities involved in the transaction, but, be very sure this is correctly done, as mistakes here can be costly. If your business is a corporation or limited liability company, you certainly want to maintain the protection that these business structures afford.

### Premises

Next will be a description of the premises. Some forms define both the rentable and usable square footage, others just give the suite number and refer to an exhibit, which is an architectural drawing of the space. Always ask how recently the space was measured and by whom. When an architect is involved, it should be easy to obtain accurate area calculations.

### Term and Commencement

The term may be the next item and includes the commencement date, expiration date and contemplates a possible delay in possession. If the space you are leasing is vacant and in move-in condition then barring strikes, riots, natural disasters or other acts of God, you will most likely not have any issues with a delay in

possession of the premises. If the space is subject to construction work, you may need to anticipate delays, or even establish a “drop-dead-date”.

When does a commercial lease actually start? There are a number of factors that can delay possession of the lease premises. Depending on the cause of the delay, the lease-term and rent obligations may or may not commence on the date set forth in the lease. Let’s look first at a situation where a newly leased premises is already occupied and the existing tenant delays departure. Under the typical lease, the owner would have no liability to the new tenant for such a delay. The new tenant’s only recourse may be to wait it out, until a “drop dead date” is reached or the premises are delivered. The “drop dead date” is the date by which, if the premises are not delivered, a tenant has the right to cancel the lease and reclaim any money on deposit. How long a tenant may have to wait to cancel a lease is a negotiable item, but sixty to one hundred eighty days is typical. Frequently, a delay in possession does not extend the term of the lease, leaving the tenant with a shorter term than anticipated. Be sure that any delay in possession automatically extends the expiration of the lease term to get the full benefit of your bargain.

Let’s now look at a leasing situation where the owner has assumed the responsibility for providing tenant improvements. Here, there are many potential delays possible. Delays caused by circumstances outside the owner’s control such as strikes, weather, governmental procedures, fires or other accidents extend the commencement date and the “drop dead date” without liability to the owner. In all the preceding examples no rent would be payable until the premises is actually delivered.

However, delays caused by the tenant in approving plans, making payments for work performed for the tenant’s account, or resulting from change orders by the tenant, are not the responsibility of the owner. This type of delay in possession may start the rent and other tenant obligations prior to occupancy.

Be sure you understand your rights and obligations to ensure that your lease will commence on time. If possession of a leased property is delayed, be sure that a Notice of Lease Term Commencement is acknowledged in writing between the parties to avoid misunderstandings later.

You are also likely to encounter the term “Substantially Complete” with respect to the owner’s delivery of the premises. This is intended to mean ready to occupy, with only a punch-list of items to be completed or corrected. Make sure you negotiate for at least thirty days to submit your punch-list to the owner, as you will certainly be too busy with other matters to do it in less time.

### **Use**

The use clause will appear with the basic business points and is important, because if too tightly written, it can affect what you are permitted to do in the premises. And your rights to sublease or assign the lease at a later time. Think about the ramifications of this clause with respect to your business, particularly if you are a retail or industrial tenant.

Many leases seek to distance the owner from any liability about the suitability of your intended use of the premises. In fact it is your responsibility to have checked out the zoning and permitting process before you sign a lease and begin to operate your business in the location. Before signing any lease you must go to the governing authority and ensure that you can get the necessary license or permits to operate in the location. Above-ground-floor retailers and ground floor office tenants take note; there may be severe restrictions about your use, for example, many communities now prohibit retail signs above the ground floor. Always ask!

### **Rent Clauses**

Depending on the type of lease you are working with, the rent will very likely cover a number of clauses. First, the base rent will be stated along with any negotiated increases or CPI increases.

Subsequent clauses will deal with who pays which expenses. For example, if the tenant pays the expense directly or reimburses the owner for actual expenses, there will be a clause to cover that aspect of the lease. Where the owner pays a particular expense as part of the base rent, they will seek to protect those costs from increasing.

### **Operating Expense Increases**

We've discussed the various kinds of rent structures common to leasing, but wait, there's still more! It often comes as a surprise to tenants to find out that the rent they have negotiated is subject to various kinds of increases. The most common is the requirement to pay for increases in the owner's share of the cost of operating the building, and sometimes tenants object to this. Since this can rarely be negotiated away, let's take some time to understand this. The basic principle here is, when expenses are included in the rent they are subject to increases if the cost of providing those services increases over the term of the lease. Many of these services are a direct benefit to the tenant such as utilities, janitorial, maintenance and elevator service contracts. Some, like real estate taxes and owner's policy of insurance are not, but the payment for any increases in these expenses are borne by the tenant in most leases. Let's look at why.

Commercial property income is under constant attack from the erosive affects of time, government regulation and increased operating costs. After the taxes, insurance and operating expenses have been paid from rent receipts, the money remaining is the net income, commonly referred to as the Net Operating Income or the N.O.I. The N.O.I. is used for several important calculations including a computation known as the Capitalization Rate, or Cap Rate. The Cap Rate is used to estimate the property value and determine the refinance-ability or value of the property. Prudent property owners seek to block the erosion of the Net Operating Income to prevent a decline in property value. Likewise, increasing the Net Operating Income increases the property value.

There are many erosive forces at work that can silently reduce a commercial property value. Property taxes increase annually, insurance costs constantly creep up, utilities and other operating expenses must be monitored and re-negotiated. The lease contract rent, which is a promise to pay, is paid in future dollars. Inflation causes the future value of money to have less purchasing power. That is why the commercial lease contract contains protective clauses against income erosion. These are known as escalation clauses.

One such clause is the Operating Expense Increase clause, which can go by other names, such as Additional Rent. It allows the property owner to pass through increases of operating expenses to the commercial tenant. Normally, the pass through begins in the second year of the lease term. The first year of the lease term is referred to as the Base Year or Comparison Year. Increased expenses are compared to the Base Year and the difference is apportioned to all the tenants and “passed through” as an operating expense increase. There are numerous variations to how this lease clause is constructed, outlining the specifics of how and when these sums are to be paid. Frequently, increases in operating expenses are estimated in advance, based upon a budget, and are collected monthly as additional rent. To protect against tax and insurance increases most leases use a base year similar to the operating expense base year. However, a tax base year could be set up on a fiscal year basis beginning July first, to coincide with property tax assessments.

Conceptually, all these lease clauses serve the same purpose, to prevent a decline in rent revenue and protect the property value. Cash poor commercial property operations offer little benefit to the building occupants. Escalation clauses can help ensure that the property remains well run, clean and functional for the tenants. Expect that most leases will allow for the recapture of the increases in the owner’s expenses based upon what is included or excluded in the rent structure.

Again, these amounts are handled as an estimated amount, based upon an operating budget, and the tenant will be required to pay the estimated amount monthly in advance, with an annual reconciliation during each year of the lease term.

The lease will define your premises as a percentage of the building area or of the project. This percentage is then applied to the increase over the base year or comparison year for operating expenses, taxes or other owner's costs that are subject to escalation over the base year.

Sometimes it is possible to negotiate a cap on operating expense increases including taxes. The cap is usually expressed as a percentage such as 5% annually. Property taxes can rise dramatically when a property is sold or transferred and a limit on the amount of taxes that can be passed through to you is very important, especially if the property has been held for a long time. While you may receive assurances that the owner has no intention of selling during your lease term, that is not enough, since people still die and the property may be transferred for estate planning purposes or by reason of death. If the owner says they have no intention of selling, then giving you a cap on tax increases should not be a problem.

Capital improvements to the property should either be excluded from the operating expense increases or amortized over their useful life and only that portion passed through annually. Always ask if there are capital improvements planned and how they will be treated in the lease. Be aware that common area refurbishment such as floor and wall coverings, elevator cab finishes, and other repairs are not usually considered capital improvements. If you are leasing a space in a building with tired common areas, a portion the refurbishment could be billed to you after the base year has passed.

Note: Some smaller properties owners, usually individuals, will not want to go through all the calculations and ensuing dis-

cussions with tenants about these kinds of increases. Instead, they might simply ask for a flat percentage increase annually. While this is easier for both parties, typically this kind of increase is based upon the entire rental payment. Expense increases customarily are only applied to that portion of the rent that goes to cover a particular expense. So you could pay more for this convenience.

## Renewal Options

In order for a renewal option to be viable, any agreements to agree must be scrupulously avoided. Therefore, mechanisms to establish the future rental rate, which do not rely upon a future agreement, are vital to the option contract. Typically, one of three methods of establishing the new rental rate is used. The fixed rate option method is the clearest and easiest to understand. Unfortunately, since each side of the transaction has a different forecast of future values, it is also frequently the most difficult one upon which to reach agreement.

The second method is a Cost of Living Adjustment and is based upon one of two Consumer Price Indexes. Either an index showing the increase in cost of living for all urban consumers in a particular area, or the index of all urban wage earners and clerical workers in the nation are used. The problem with this method is that the indexes do not bear much relation to the rental value of a particular property. Additionally, many lease agreements call for annual CPI adjustments during the lease term to prevent income erosion. As a result, an option to renew based upon a CPI increase may be perceived by the owners as an extension of the original lease without any real increase in rents.

Market rental value adjustments are more flexible and meet the needs of both owner and tenant. Several months before the lease expires, the tenant notifies the owner in writing of its exercise of option. Within a specified time period, the parties endeavor to reach agreement upon the new rental rate. If no agreement

is reached, then each party hires a third party appraiser or qualified broker to establish the market value. Should the experts be unable to agree, then a third expert is usually hired to settle the issue. Some lease contracts also send the disputed estimates of value to arbitration for final resolution. Because each of these methods is costly, frequently the parties reach agreement before resorting to hiring experts.

Although, a market rental value adjustment may sound like an agreement to agree, as long as there is a mechanism capable of binding the parties to a rental rate, it is likely that the option to renew will remain valid. Careful consultation with a qualified attorney can prevent misunderstandings at renewal time.

### **Operating Hours of the Building**

Normally you will have access to your premises 7 days a week, 24 hours a day, 365 days per year. And you can expect that the electrical plugs and lights and elevators will be operating. Many of the other services that the owner is obligated to provide, such as heating, ventilating and air conditioning (HVAC), guard services, building engineers, etc will only be available during the building operating hours. If you need to operate on an extended hour or 24/7 basis, the cost of providing you with these services will be charged to you, if they can be provided at all. This is a big issue for some properties and a footnote for others. In larger multi-tenant buildings it can be very costly to provide after-hours HVAC and require an engineer on site to do so. Other buildings are set up to provide these services at the flip of a switch in your premises, using computer billing. Many smaller properties, or those using net of services leases also have no problem with extended hour operations since the tenant is already paying for the services directly. If you need extended hours of operations, broach the subject with the owner and make sure the services you want can be delivered affordably before you get too far along in the transaction.



## **Maintenance, Repairs, Alterations and Additions**

The lease will set out the obligations of the parties for maintenance and repairs of the premises, and you must be sure that this accurately reflects your understanding. As a general rule, in a full service gross lease used in office space, or in any kind of lease covering multi-tenant property, the tenant will be responsible for the interior and owner for the exterior and common areas.

At a later date you might want to reconfigure your premises or do other remodeling work. This is always subject to the owner's prior written consent and approval. In highly controlled properties such as high rises or large shopping centers, expect this to be very restrictive as to what you can do, who can do the work, how, and when the work can be done. In some cases you can negotiate to permit alterations up to certain dollar amount without going through a consent process, and I suggest you do this whenever possible. This can be a great help if you need to sublet a portion of your premises or need an image makeover. You will be required to keep the property lien free.

At the end of the lease you will be required to return the premises in the same condition in which you received them, normal wear and tear excepted. The owner may have the right to require you to restore the premises to its original configuration or remove your fixtures and equipment. Be sure to exclude any original tenant improvements from this requirement. Try to get the owner to waive any restoration rights for subsequent alterations at the time you make application for consent to alter the premises during the lease term. You will also need to remove the improvements before the lease expires or the owner could continue to charge you rent. If you wait to remove any improvements or fixtures that you are required to remove, you could be considered a hold over tenant and subject to substantial rent increases under the holding over provision of the lease.

## **Insurance Issues**

Regardless of whether or not you are reimbursing the owner for their insurance policies, you will be required to provide your own insurance. Start by sending this part of the lease contract to your insurer along with any clauses that deal with attornment, indemnification and/or subrogation.

Some of the coverage you may be required to provide include:

Liability

Casualty to the tenant improvements

Business or rent interruption

Lost rental value

Plate glass (retail or other ground floor tenants)

Be aware that if your use of the premises increases the cost of coverage to the building, any adjacent premises, or common areas, that cost would most likely be passed on to you. After you have received assurances from your insurer that you can obtain the coverage required, discuss the ramifications of the indemnification, attornment and subrogation with your legal counsel.

## **Assignment and Subletting**

We've gone over some of the aspects of assignment and subletting and these clauses are becoming more and more restrictive. Be sure you know your rights and obligations as well as the rights retained by the owner. The owner will always require that they consent to any assignment or subletting.

Some of the key issues to look for are:

Who is entitled to any bonus rent from the subletting?

Does the owner have the right to terminate the lease or a portion of the lease in the event of a subletting?

What are the rental rates you can advertise?

How much time is the owner permitted to give or withhold consent?

What are the legal fees charged by the owner in granting consent?

What uses are restricted from subletting or assignment?

Can the owner increase the rental rate to current market level in the event of sublease or assignment?

What financial qualifications will the subtenant or assignee be required to have?

Be aware that many options to expand or renew are personal to the original tenant and do not pass with an assignment or sublease.

### **Early Termination Rights**

Sometimes tenants are concerned with outgrowing the space before the lease expires. Usually the solution is to sublet or assign the lease. However, if the sublease and assignment provisions are too restrictive, you may want to try to negotiate an early termination of the lease. There are costs associated with the right to terminate early. Normally, you will be expected to pay several months rent while the owner finds a substitute tenant. If the owner has provided substantial amounts of tenant improvements on your behalf, you must expect to repay the unamortized portion of the improvements. If a broker has been paid a commission, the early termination penalty may include repayment of a portion of that fee. While early termination penalties are expensive, for some tenants they are preferable to the position of being a sublessor and the potential liabilities of those duties.

Tread carefully here and be sure to have discussed this clause with your legal advisor. This book is not a substitute for competent legal advice!

## Relocation within the Project

Another lease clause that can have serious economic consequences is the owner's right to relocate you within the complex. Owners need this in multi-tenant properties to allow them to plan for the growth of superior tenants or properly plan a shopping center. While you might have to live with such a clause in your lease, you may be able to provide yourself with some protections. First, the owner should pay for the cost of the relocation and improving the premises to a like condition as your original premises. However, there are a number of incidentals such as reprinting stationary and brochures, telephone or other equipment relocations, and above-standard tenant improvements. How much notice you will be given to relocate is critical. If you need high speed Internet or other connectivity, you need to anticipate the lead-time required for re-installing those services. Ask for some cash compensation to cover the inconvenience and discourage relocation. Toward the end of your lease you might not want to be relocated so ask for the option to terminate the lease if relocation is required during the last year of the term.

## Holding Over

Holding over is another clause that can cause your rent to double. At the end of the term, the owner may need you to vacate on time to avoid delaying the possession by another tenant. To ensure that you do vacate on time, a provision is made in the lease that increases the rent if you stay beyond the lease term, without the owner's consent. This can be an increase of 200% to 300% of the base rent. If you obtain the owner's consent to stay, this will not be an issue. The lease will become a month to month tenancy and the owner can adjust the rent upon 30 days written notice.

## **Late Charges and Interest**

The late charge is used to offset the costs incurred by the owner in collecting late rent and as a preventative measure against late rent. Most leases do provide a grace period, 3 to 5 days is typical. You can often negotiate more days, but I think it might be better to negotiate one or two forgiveness' of late charges per year as this will probably save you more money if you forget to pay on time. The interest rate is for longer, uncured monetary defaults and is applied to those overdue amounts in addition to any late charges.

## **Personal Options and Multiple Options**

Be aware that many options to expand or renew are personal to the original tenant and are not transferable. Options are only viable if there is no default of the lease. It is better if the lease specifies that there are no "uncured monetary defaults", as this is more specific and avoids the risk of losing an option for minor or inconsequential defaults that are easily cured upon notice. Be sure that all notices of default are required to be in writing and delivered to you by certified delivery. Multiple options require that preceding options be duly exercised for subsequent options to be viable.

## **The Entire Agreement**

The balance of the lease must be reviewed by your legal counsel and discussed thoroughly to make sure you understand what you are signing. Do not get lulled into thinking that the bulk of the lease is boilerplate, you never know what may be buried in the miscellaneous provisions.

Most leases contain a provision stating that this is the entire agreement and that you have not relied upon any other representations and that there are no other outside agreements. To make sure this is accurate, review all your proposals and notes on the transaction and check to see everything you have been promised is in the lease.

## Lease Execution

So now it's time to get the lease signed and hopefully all your hard work will pay off with the granting of an interest in real property by the owner. You will be required to sign up to four copies of the lease in original signature. I suggest you initial every page of the lease when you are signing to prevent any accidental or intentional substitution of pages. Next you need to provide good funds to cover the first month's rent and any security deposits, or contribution to tenant improvements. You also need to deliver an insurance binder from the insurer.

The lease is not a contract until the owner has signed and delivered it back to you and, up until that point, the deal may be terminated by either party. This does not happen often but if it happens to you, see your attorney as you might have a cause of action against the owner.

After the lease is delivered to you, the obligations of the parties begin. If the owner is responsible for constructing the premises for you, the working drawings will commence at this time. During the working drawing stage, you will have certain obligations to approve the designs, provide information about furnishings or fixtures, select finishes and the like. Be sure to calendar the critical dates so that you are not the cause of any delays in completing the work. Delays caused by tenants can cause the rent to start even though the premises have not been completed and delivered to you. Once the work starts be sure to schedule your cabling, equipment and furniture installers with the contractor or project manager to ensure a smooth transition into the building and an undisputed commencement date. Once you've moved in be sure to execute a notice of lease term commencement with the owner.

# 17

## Negotiations

Now let's talk about negotiation. First, whether or not you like to negotiate is irrelevant. You must learn to negotiate because you are going to encounter top negotiators who will take you to the cleaners if you don't recognize and know how to counter what they are doing. These top negotiators sometimes include owners and their brokers. And, they'll use negotiating techniques to get what they want. Therefore it is critical to learn how to negotiate.

If it's not the most comfortable thing in the world for you to negotiate then let me offer you this, think of negotiating as a game. In a game you are seeking to win, because winning is the object, but you are not overly concerned about losing. In other words, the best negotiators don't let emotions, such as stress, dictate the outcome of a negotiation because it's simply a game that they are playing. This is easier if you are not tied to the outcome. In other words, if you can resign yourself to walk away if you have to, you'll be much more apt to treat the negotiation as a game and you'll be more effective. If you maintain this attitude, you'll be able to feel excited about the negotiating process.

So let me share with you some of my thoughts about negotiations, and then I'll walk you through some of the techniques you might encounter in the process of negotiating. As with all techniques, you don't necessarily have to use them to get what you want, and that's your decision, but you better know when they are being used against you, and the counter measures necessary to be an effective negotiator.

So what's the process of negotiating? Well, every negotiation is different but some general rules apply. My first rule of negotiating is to avoid over negotiating. After all, when it comes to real estate, it's all negotiable! Virtually every aspect of a lease transaction is negotiable, but that doesn't mean you would want to negotiate every point. A common mistake is over negotiating. Overkill on minor points is an error that can evoke feelings of frustration, anger and resentment in the other party. When the "romance goes out of the deal" it is usually attributable to over negotiating.

The second rule is to prepare. Since there are thousands of variations of lease clauses that need to be combined with the economic variables of the transaction, it is important to reach agreement on all the key issues early in the process. Structure your lease negotiations into two components, the general business terms and the lease language review. Proper Preparation Prevents Poor Performance. Successful negotiators take the time to prepare before they enter the negotiating arena. Develop an agenda of deal points you wish to cover. Start with those points that can be readily agreed upon. As you work toward the more difficult issues you can reference all the prior points of agreement to help you get through impasses. Decide in advance how far you will bend on the business terms and stick to those limits.

My third rule is to meet in person with all parties involved whenever possible. Negotiating the lease language can be left to the attorneys but you run the risk of losing control of the negotiation and it can be expensive. It's almost always better to take the attorney's comments directly to the table yourself. Taking the time to understand these points will allow you to pare down the list in advance, eliminating small or inconsequential items.

I like to negotiate in person as much as possible. Unfortunately we are not always afforded the opportunity or have the necessary time to meet in person. We often find ourselves in



a position of negotiating over the phone. Miscommunications occur far too easily on the telephone because we cannot see the other person's nonverbal communications and signals. It is also much easier to say no over the phone than it is in person. Fortunately, we can strengthen our position substantially when time or distance forces us to use the phone to negotiate. As with any negotiation the preparation of your position and establishment of the limits of your concessions is important to your success. Take the time to commit your position to writing and then fax or email it before your phone call to clarify and strengthen your position. Turf exists, even on the phone. Make sure that you place the call to ensure that you are working from your agenda, following your order of events and concluding the call when you want.

Your body language as you speak on the telephone is important. Have you ever had the feeling when talking with someone on the phone that they were leaning way back in their chair, perhaps barely listening, in a very relaxed position? So too is your body position transmitted through your voice. I think the best body position is standing; yet relaxed and smiling as you speak. This conveys the message that you are interested and alert. If you get too laid back or relaxed, you may find yourself making too many concessions, too quickly. Note taking is a listening technique that is highly relevant in negotiations. To close a telephone negotiation with the clearest possible communication, verbally summarize your conversation. After the call, your notes can be very valuable to confirm your understanding with the other party. Immediately fax or email your notes including a summary of your understanding to avoid problems later.

This is so important that I'll say it again, written preparation and strong communication skills can help overcome the inherent disadvantages of negotiating over the telephone. Use faxes or email to employ the power of the written word and strengthen your position. Watch your body language, smile as you speak, fax

or email copies of your notes for clarity and you will be doing a superior job for yourself.

Next, set time limits for each negotiating session to help avoid deadlocks and prevent over negotiating. If you need to stage your negotiations into two or three sessions, then prepare your presentation of the essential points in advance. One way to do this is, if you have many minor lease comments, is to set up a separate meeting to work on these after agreement has been reached on the business terms. Once you begin your meeting remember that rapport is important in any negotiation, so spend the first few moments establishing rapport. Once you have rapport you need to boldly ask for what you want, usually one thing at a time. You need to keep asking until you have everything you want or until it becomes apparent that the other side is not willing to concede on an item. Skilled negotiators are trained to ask, and ask and ask again. So develop many ways to ask.

If the other side is skilled at asking for what they want, they will ask until they get exactly that! It is important to develop at least ten ways to say NO to this type of negotiator. This takes practice and discipline but you can master this technique if you are prepared to walk away from any deal. If you have to have the deal, the other party need only wait you out to win. The appearance that you are prepared to leave the deal can neutralize the pressure to say yes.

Next you need to know how to make concessions. Concession patterns are often detectable in the other party's negotiating style and by getting to know as much as possible about the other party you can gain the advantage. Test for a concession pattern by bringing several minor issues to the table early in the session. Does the other party like to dispose of the issues quickly? The negotiator that likes to dispose of one issue in order to get to the next one may tend to give up too much too soon. Does the other party like to take a long time to consider the issues? Putting

too much time pressure on this individual may cause them to walk away. Do they attempt to extract concession for concession? If so, bunch several demands together to minimize your concessions. Testing the other party for style and patterns helps you see how far they will go to make a deal. Likewise, make sure your concession patterns are not too easily detected. Develop a habit of giving in slowly to the other party's demands. It is easy to fall into the trap of conceding incrementally and vary the quantity and timing of concessions to create an irregular pattern. Make minor concessions to gain the concessions that are most important to you.

If you start to feel trapped into making concessions that you don't want to make, there are several ways out. You can invoke the absent authority, citing the need to consult with another decision-maker, or you can declare a time out to consider a counteroffer. Break off the negotiation smoothly by setting a time to meet again, using the time to plan for the next session. Also, be aware when others are using the absent authority on you.

If the other party makes an outrageous demand, it may be their way of testing your resolve to make the deal. If you are committed to make the deal you may find yourself considering those concessions that were out of the question before. If you are the recipient of such a demand try these three defenses. Ignore the demand until it has been raised for the second or third time. Laugh it off and tell them they can't be serious or use the walk away. Observe concession patterns and the negotiating style of the other party.

Give in slowly. Learn to say NO. Be prepared to walk away from any deal by having an acceptable back up location. It helps to be aware that an outrageous demand may be a test of your resolve. During your negotiations take the time to write down every agreed upon point. Do it as the point is agreed upon. This adds a feeling of certainty to what has been agreed upon and pre-

vents the other side from going back on something that has already been agreed upon. It also allows you to wrap up the negotiation by going over each point that you have written down and then, if necessary, have each party initial what has been written. While the initials do not constitute a legally binding agreement, they help to provide closure.

These are some of the most common negotiation techniques you will encounter, but the real lesson here is, that you will run into highly skilled negotiators and you must be prepared. By learning these techniques and others, you'll avoid serious gaffs in negotiations and show yourself to be a worthy negotiator.

There are 7 major techniques that you should recognize in a negotiation. They are:

- The Walk-away
- The Absent Authority
- Deadlines
- Nibbling
- Grinding
- Reframing Questions
- Controlled Emotion

## **The Walk-Away**

One of the simplest techniques that are employed in negotiating is the walk away. It is simply what the name implies. One party gets up and walks away from the deal. Not because they don't want the deal, but because they want to test the resolve of the other side. It is also important to understand that it may backfire. It is kind of like bluffing in poker. They may call your bluff.

So in order to employ this technique it is important to be serious about letting the deal go if you have to, which goes back to the attitude that we talked about earlier. The best result of a walk away is that the other side calls you back to make the concession that you walked away about. If some one walks out on you, you need to know how important each concession is and be willing to call someone back if you are willing to give in. Don't just give in when you call them back though. Call them back by saying that you'll concede on this issue if they'll concede on another. This let's them know that you want to continue, but that you are also not a push over. When the other side walks away, it can sometimes be a great time to ask for significant concessions because they may be looking for a way to come back. They may have bluffed and could be hoping that you don't call their bluff.

### **The Absent Authority**

This is a common and powerful technique that allows you to slow down making concessions and many times eliminates the request for concessions from the other side. It is simply the technique of telling the other side that there is someone from whom you need to get approval. If you find this technique being used by the other side, then simply request to know the authorities opinion on something before making a concession. In other words say, "I'll consider that if I know for sure that your associate will agree to it." This will kill their attempts to pin you down and cause them to either get approval or admit that it's not that important.

### **Deadlines**

When you set the deadline you control the negotiation. Because approximately 80% of the agreements are reached in the last 20% of the negotiation, it is important to understand that the person who sets the deadline manages this aspect of the negotiation. And be aware when others invoke deadlines. As your dead-

line approaches, the more likely it is that the other party will concede to your demands. Combine the power of competition with your deadline to increase your effectiveness. Suppose that in negotiating lease terms I say, "It's between your's and one other property." If we are apart on an economic issue, I can say that I want to give this further consideration. "I'll give you my final determination on Friday", if they want to wrap up the deal sooner, they may need to make some additional concessions.

Always test the other party's deadlines. When the other party is attempting to set the deadlines, it is important to question their deadlines. If they say to you, "I need your answer by Friday morning." don't acquiesce without finding out why. Good responses to this statement would be: "Why, Friday?" or "Do you have another prospective transaction for this space?" If they answer "Yes." to this last question ask, "How long have you been working with them?" or "How far along are you in that deal?" Dig into this issue to test its veracity. The more you question, the better your chances are of eliciting responses that will restore the negotiating power to you.

When you set the deadline you have the power to change it. Extending a deadline is a delicate aspect of the negotiation process. It is a technique that can be used to your advantage, but it should be used infrequently. Continually extending deadlines can be misconstrued. If you call me on Friday and ask "What is your decision?" I would probably respond by asking you about a deal point I want a concession on. If you decline to concede this point I may consider re-establishing my deadline to allow you time to reconsider. I might say, "I haven't had the time to reach my decision yet. However, unless you can meet my needs by Wednesday, I'll probably take another property. How about calling me back on Wednesday or sooner if you change your mind?" The key here is to recognize the other party's attempts to control the deadline and to establish your own deadlines.

### **Nibbling**

Nibbling is asking for additional concessions after reaching agreement. It uses the concept of commitment and consistency. Whether you choose to use nibbling in your negotiations is a personal decision, never-the-less, you should know about nibbling. The most common form of nibbling occurs when you have just made a major buying decision for example, a car. After you have made your deal, the car dealer offers to sell you an array of options. The dealer knows that you are most susceptible to buying these items immediately after making the big decision. These items are loaded with profit for the dealer. The selling or negotiating that goes on just after the sale or agreement has been reached is called nibbling.

There is tremendous tension during the negotiations for both parties. That tension is released when the agreement is reached and both parties feel a great sense relief at the moment of agreement. This is when the nibbler casually presents one or two additional requests. Often they are couched in an assumptive closing statement like, "Of course that means you will be paying interest on the amortized tenant improvements". The other party, not wanting to reopen the negotiation and risk losing the deal quietly goes along.

The primary defense against nibbling is to make the nibbler feel cheap. Another defense is to offer to re-open the negotiation. You might say, "Well, I thought we had this deal all worked out. However, if you want to re-open the negotiations then I guess we'll have to start over." Remember that the other party feels the pressure too and probably are not inclined to re-open the negotiation.

Another way to defend against a nibbler is to invoke the absent authority, simply defer the decision to them. Often the nibble will be withdrawn at this point. It will be easier to say no to a nibble when the glow of a successful negotiation has faded. Remember that at the moment of agreement you and the other

party are both susceptible to give up additional concessions. Prepare your defenses against nibbling in advance and anticipate that they may come.

## **Grinding Away**

Have you ever felt as though the other party will never stop coming back for more during a negotiation? That each time you get close to agreement the other party makes additional demands? That they are grinding away and you are powerless to stop them? This is known as grinding and there are several good defenses against the grinding away process. Always ask something in return for each concession you make. This is called trading off and it is important to a successful negotiation because it creates value in the concessions you are making. No matter how inconsequential the concession may seem to you, develop the practice of asking for something in return. In developing this practice know that timing is important. Take time to consider carefully the other party's demands to avoid responding too quickly. Overly quick responses tend to send the message that you don't take the demands seriously or that you are trying to shift away attention from the issue.

There is a principle that says that the value of services is greatly diminished after the services have been rendered. For this reason it is better to ask for a trade off when you make your response rather than save it for later. However, if you have established value in your concessions by asking for something in return, even if you don't get it, you can say "We did that for you back then, now we want you to do this for us, fair enough?"

Withdraw a prior concession to send a strong bottom line message. Grinders need to be told when to stop. When you take something back that you have previously given up you are sending a bottom line message that says, "We have gone as far as we will go and if you keep asking for more, we will need something back."



## Re-framing Questions

Re-framing questions are questions that cause you to focus on something different. This technique is a valuable one to both use and recognize in a negotiation. Listen carefully for when the other side in a negotiation says things like “I think the question we need to ask here is...” Chances are they are about to attempt a reframe. The way to counteract this is to listen carefully to the question and then to not agree with it if it does not focus the negotiation on the points on which you need to focus.

## Controlled Emotion

There are negotiators that have mastered the use of controlled emotion as a negotiating tactic. The most recognizable are flinching, anger and the walk away.

Have you ever been in a situation where after quoting your asking price the other party physically flinches and says, “I had no idea you were asking that much! I’ll never pay that price!” If you reacted by lowering your price or offering some other concession, you probably fell prey to the flinch. To defend against the flinch you must first recognize it for what it is. Flinching is both an opening gambit designed to lower your expectations and more important, it is an expression of interest. Respond calmly, imply flexibility without making a specific concession, then turn the discussion to the benefits of your tenancy. Attempt to get the other party to make the first offer, to establish the bottom of the settlement range.

Sadly, some people still use anger to gain concessions in a negotiation. This tactic is designed to get you to deal with the other party’s emotions rather than the issues. We often find this tactic tied to the walk away. The best defense is to focus your attention on the movement of the goal concessions as they cross the table. Keep your attention on what is going on with issues and

not what the people are doing in the negotiations.

# 18

## Renewing or Extending a Lease

On the face of it there would not seem to be much to think about when renewing or extending a lease. Yet there are some costly and common mistakes. One of the most common mistakes is simply exercising an option to renew when market conditions favor the tenant. Some others include:

Waiting too long to renew the lease

Obtaining information about market conditions from the owner

Failing to establish a new base year

Not renegotiating a security deposit

Failing to obtain a refurbishment allowance

Not creating a verifiable sense of competition with the owner to retain you as a tenant

When market conditions favor the tenant, it may be far better to renegotiate the basic business terms than to simply renew. I always recommend that a tenant take a good look at what the market has to offer 6 months before the end of the lease term or before exercising an option to renew. If you use a broker to do this, be careful not to abuse their time. If you end up moving, the broker will get paid, but if you stay put they may not. I suggest

you work out a consolation compensation if you do not relocate. You would not appreciate having your time wasted and being used as a free source of market information about your business, and brokers are no different. You can also make an exclusive tenant representation agreement with a broker, who can then be paid by the owner to represent you in the renewal as well as to the open market. Since this does create a verifiable sense of needing to compete to retain you as a tenant, you can benefit greatly from this action.

As you are approaching the end of a lease term, the most common mistake is waiting too long to open discussions about renewing. Begin the negotiations early enough to allow time to relocate if the transaction fails to reach satisfactory terms. It is clearly in the owner's best interests to delay reaching agreement until time is too short for you to relocate before the lease expires. This kind of pressure on a tenant can be costly. Start your renewal discussions early and set and control the deadlines for response. If your deadlines are not met, begin looking for a new location and let it be known that you are looking around.

In the section on letters of intent and again in the section on understanding lease clauses we talked about how rental rates are established upon exercising an option to renew. It would either be; a fixed rate increase, a CPI increase, or fair market value or a percentage of F.M.V. If rental rates have not risen to the level of a previously negotiated fixed rate increase, then a re-negotiation is essential to avoid overpaying. While a CPI index is commonly used to establish future rental rates, it bears little relationship to commercial property rental rates, which are a function of supply and demand. Additionally, many such renewal options contain a statement that the renewal rate shall not be less than last rent in effect at the time of renewal, which can cause the renewal to be at over-market rates. If the escalated rent is above market then a re-negotiation is required.

If the renewal option is the fair market value, or a discounted percentage of F.M.V. then the vital task is to understand the market. This includes any inducements to lease being offered to new tenants coming into the property, which otherwise may not be calculated into a renewal option by the owner. Do not rely upon the owner to provide you with this information.

Now let's take a look at what is at stake for the owner if you move out. In a soft market it might take several months to locate and successfully negotiate a lease with a new tenant after you vacate. All the while the rent has stopped. The owner is likely to have to provide tenant improvements for the new tenant. This can range from just paint and carpet upgrades to extensive renovations, costing from \$5 to \$30 per square foot. There are the hard costs of renovation, such as the contractors work, and the soft costs such as the architectural and engineering costs permits and supervision. No rent is collected during the construction period. Additionally, the owner might have to offer free rent or a graduated rent schedule to procure a tenant. In very soft markets, moving allowances are offered as a lease inducement. The owner may incur additional legal fees to prepare, review and negotiate the lease contract. These costs can become quite significant.

On your side of the equation, there are the moving expenses and the disruption to your business to consider, but if the market favors the tenant, take the time to learn the market and renegotiate rather than renew and ask for some of the concessions covered here. You may be successful in obtaining a refurbishment of the premises, a rent holiday or period of reduced rent as well as ensuring that your rental rate is truly a market rate.

If you have been faithful in your performance of the lease obligations, then, perhaps a partial return of your security deposit may be in order. Security deposits do not typically earn interest for you, and over a ten-year term you'd be surprised at how much that can cost you. A \$5,000 deposit earning 6% interest com-

pounded monthly, is worth \$6,744 after just five years. Not that much you say, but after ten years it grows to \$9,096, nearly double! So get that security deposit back if you can!

A very costly mistake is failing to establish a new base year. Most renewal options do not reestablish the base year as the renewal year. Therefore, all the increases in operating expenses, taxes and insurance are then compared to the original year of the lease. All of the escalations that have accumulated over the previous years of the lease term remain in effect for the renewal period. By establishing a new base year, those are washed away and for the first year of the new term, you will be relieved of the obligation to pay any operating expense pass-throughs.

Again, decide early whether you are going to simply exercise a renewal option or re-negotiate your lease. Then study the market and control the deadlines to avoid being rushed into less than favorable renewal terms.

### **Wrap it up, I'll take it**

If you've made it this far in the book, I believe you will be better prepared to lease a commercial space than many of the clients I have been privileged to have served over the past two decades. Whether or not you choose to use a broker is up to you, but by being well informed about leasing commercial property you will be fore-armed, and that is a valuable asset when dealing with property owners or their skilled agents. Good luck and remember, business is a game and you can make up your own rules of how to play. So, be creative, playful and have fun, it's a short trip and you only go around once!

# 19

## A Lexicon of Leasing Terms

**Above Standard Tenant Improvements:** Improvements that exceed the building standard (see building standard)

**Agent:** One who acts for another as a fiduciary. A real estate license is required to act as an agent for another in real property transaction.

**Assignment:** A transfer of an interest in real property, in this case, the leasehold interest.

**Anchor Tenant:** A large retail tenant that draws traffic to the shopping center.

**Base Rent:** An amount of rent before adding any escalations.

**Base Year:** Usually the first year of a lease to which future operating expenses are compared for the purpose of calculating expense increases.

**Building Class:** Class A normally post-1960 construction, Class B pre-1960 construction. Also used subjectively to describe the quality of a property. Class A excellent overall; Class B good overall, Class C older with some functional defects; Class D deteriorated needing renovations

**Building Standard:** The quality level of the materials the building is offering tenants for use in constructing the tenant improvements.

**Build-out:** The proposed construction for a new or renovated suite.

**Capitalization:** A method of determining property value based upon income.

**Capitalization Rate:** The percentage rate applied to the net income to determine value. Also known as Cap Rate.

**Certificate of Occupancy:** Issued by governing authorities certifying the right to occupy a property.

**Common Area:** Building or project areas used in common with other tenants including service areas such as maintenance rooms, janitorial closets, hallways, elevators, etc.

**Consumer Price Index:** A governmental index used in determining the cost of goods and services. Used in leases to prevent the erosion of income by escalating the rent payable annually.

**Default:** The failure to comply with an obligation required under the lease contract, may or may not be monetary.

**Demising Walls:** The walls that separate one tenant from another or from the common areas.

**Drop Dead Date:** The date by which, if the premises are not delivered, the tenant may terminate the lease.

**Effective Rent or Rate:** The average of all the years of the rent after



deducting any landlord concessions such as free rent or over standard tenant improvements.

**Escalations:** The means by which a lease provides for increases in rent or for recovery of operating costs or tax increases during the term of a lease.

**Estoppel Certificate:** A certification by tenant that the lease is full force and effect and confirming the economics of the lease.

**Expense Stop:** Used to cap the amount the landlord is willing to pay to cover a particular expense or group of expenses such as operating expenses.

**First Right of Refusal:** Grants a tenant the first right to match an offer to buy or lease a property or premises, or refuse such an offer, after an offer has been tendered by a third party.

**Full Service Rent:** An all inclusive rent covering rent, operating expenses, taxes and lessor's insurance, subject to escalations when these expenses increase after the first year of the lease.

**High Rise:** 25 story building or greater.

**Hold Over Tenant:** A tenant in possession after the lease term expiration.

**HVAC:** Heating, Ventilating, and Air Conditioning Systems

**Low Rise:** Building with six stories or less.

**Master Lease:** The controlling lease covering a property, may control a subsequent lease or leases such as a sublease or assigned lease.

**Mid Rise:** Seven to 24 story buildings.

**Mixed Use Project:** More than one use within a project such as office and retail; office and hotel; office and apartments; retail and apartments.

**Mullions:** Material used to divide window lines to allow for the attachment of walls in creating rooms.

**Non-competition Clause:** Prevents the owner from leasing space to another tenant that competes with an existing tenant.

**Non-Disturbance:** Protects a tenant from loss of its premises in the event of default by another party. If the owner is foreclosed, a non-disturbance agreement from the lender protects the tenant. If a sub-lessor defaults on a lease, non-disturbance agreement from the owner protects the sub-tenant.

**Notice of Lease Term Commencement:** A document executed between owner and tenant defining the actual date the lease commenced, which may or may not define a new expiration date.

**Novation:** To make new, such as a new lease agreement in lieu of a sublease or assignment of a lease.

**Parking Ratio:** The number of parking spaces available per 1,000 square feet of space leased, or for an entire project.

**Pass-throughs:** Operating expenses and/or tax increases paid by tenant under a lease agreement are said to be passed-through to tenant.

**R&D Building:** A combination of office and production space as might be used for research and development.

**Renewal Option:** Grants the tenant the right but not the obligation to renew under specified terms and conditions.

**Security Deposit:** A deposit made by a tenant to a landlord to secure tenant's promise to perform its obligations under the lease.

**Space Plan:** The preliminary space design defining the tenant's space requirements, often includes furniture layouts.

**Tenant Improvements:** Improvements made to a property to make the space suitable for the tenant's intended use, whether paid for by landlord or tenant.

**Work-letter:** A list of the quantity and type of component parts that will be used to construct tenant improvements, usually provided by landlord to secure a tenant for a property.

**Working Drawings:** A complete set of plans, normally developed after lease execution, defining the precise layout and construction of the premises, suitable for obtaining permit and true costs.

# Notes