Chapter 1

Yes, You Can Negotiate a Great Commercial Lease

In This Chapter

- Making the most of this book
- Starting the commercial leasing process
- Seeing the leasing process through the landlord's eyes

The business terms of a commercial lease agreement, combined with the location, represent the platform that your business or company is built upon. Your business may be able to change its products, services, pricing, and marketing — but once you've signed a long-term lease commitment, you've got to make the location work. It's do or die time. And the more money you spend building out your location, fixturing it, and stocking it with merchandise or inventory, the more capital you have invested in the success of that business.

If we could have one wish come true, it would be that business owners take the leasing process more seriously and realize that when the dust settles, they better have gotten it right, because profit is king. And it all starts with the location and lease agreement.

This book aims to spell out how you can successfully negotiate a great lease. But first, a few preliminaries.

Understanding What a Profitable Lease Agreement Is

A *profitable lease agreement* does two things:

- It lets you the owner, operate a successful business, drawing a good salary from the company while servicing the bills, loans, and debts of the company. It gives you the privilege of employing people, and possibly allowing for future expansion, and thereby becoming truly rich and profitable at multiple levels.

- It enables you to acquire equity and goodwill, possibly leading to selling the business, recouping the investor's capital, and either retiring or allowing you to open another business.

The future salability of the business is often overlooked by business owners. The Lease Coach is often hired to work with entrepreneurs and business owners when buying or selling a business because a commercial lease agreement is involved.

Too often, The Lease Coach sees business owners not only struggle to take home a salary, but at the end of their 5- or 10-year lease term, they end up closing the business because no one wants to buy it. There was a story in Dale's local newspaper about a family-run business that after 30 years simply closed its doors for retirement. No one wanted to buy the business, which was a shame. You can assume that the owner of the business didn't get rich running his business or it would have had many suitors willing to buy it. If you spend all those years building a business and then you can't sell it, you can't get those years back.

Avoiding bad leases and knowing what makes them bad

A bad lease agreement may hold you back from making a good profit. A bad lease agreement could mean a bad or mediocre location. Dale and Jeff see this all the time. Great retailers, superb restaurateurs, exceptional service businesses in poor or mediocre locations do less business than they could in a better location. On the other hand, perhaps you picked a great location, but leased too many square feet (or too few), this can be a problem as well.

Combine a poor location with a high rental rate and you have a recipe for disaster. Your business will never succeed, let alone sell for a profit. Too many entrepreneurs are shopping for cheap space, but for the most part, you get what you pay for location-wise. This isn't to downplay the need for skillful negotiation; you don't want to pay too much for a good location — it's all relative. In many of the larger plazas and enclosed malls, the property in general may be recognized as an excellent location, but getting stuck in a quiet area of the property may make your business less visible than you would like.

A lack of adequate parking for your customers can make for a bad lease. A multi-unit restaurant tenant The Lease Coach is currently working with for a midterm rent reduction has come to the unfortunate realization that their newest location is parking starved. Just when people are hungry and want to come to their restaurant, the parking lot is already full of vehicles. Customers come in to complain that they can't find a parking space even close by — and many times cancel their reservation, go back to their cars, and drive away.

High rental rates — especially if combined with restrictive terms that make running your business difficult, if not impossible — can also hamper your future success.

Making a good lease a great lease

Brevity in a lease agreement is the enemy of most tenants. A good lease agreement is longer, not shorter. Never assume that what the lease doesn't say will play out to your benefit later — it won't. As the tenant, you want everything that could possibly be an issue addressed in your lease agreement.

Often it's what's missing from a lease agreement that really comes back to hurt the tenant.

For example, if a business owner wants to sell their business and assign their lease agreement to the buyer, the lease must have a comprehensive lease-assignment clause. However, landlords often include conditions controlling or potentially prohibiting the lease assignment (unless suitable wording is added for the tenant's protection). Another example is that most lease agreements have a *permitted use* clause stipulating what products or services you can sell — or perhaps not sell. If you open a ladies clothing store and realize you also want to sell shoes, handbags, watches, and other accessories; you may not be able to sell them if your lease agreement specifically states that your permitted use is ladies clothing. Anticipating what items you may want to stock or sell will allow you to negotiate and add appropriate wording to the permitted use clause.

Making a good lease great requires anticipation of what may change in your industry, in the economy, and with future competitors, and then capturing all that into the lease agreement.

Making a good lease great means removing, deleting, or negotiating restrictive clauses in the lease agreement that will hold your company back. For some tenants, the renewal-option clause can be the difference between whether you get to stay in your location for several renewal terms. A demolition clause can force you to move out of the premises if the landlord wants to knock down the building and put up a different type of building. A relocation clause can force you into a costly relocation. All of these are scary scenarios requiring proper guidance from a professional lease consultant who is working for and being paid by you to protect and serve your needs — the tenant.

Negotiating a truly profitable lease agreement

A profitable lease agreement may include an exclusivity clause preventing your indirect competitors or neighboring tenants from selling your primary permitted use products or services. A profitable lease agreement would include a clause allowing you to operate the days and hours of your choosing. This can also mean the right to close or open early/late hours on days where it is unprofitable to remain open. One landlord wanted to require that an optometrist tenant (our client) open on Sundays. We negotiated so that the doctor was allowed to close on Sundays and holidays.

Try to think in terms of whether you'd buy this business based on its current lease agreement. As a prospective buyer, what parts of the lease agreement would you not like? Would the rent seem high? What about the operating costs? Would a shortage of parking or an undesirable neighboring tenant drive away both your potential customers and buyers of your business? Thinking about these issues beforehand can make all the difference to your decision-making process.

Seeing yourself from the landlord's perspective

Business owners often fail to understand that a landlord doesn't just want any tenant; they want the best tenant possible. Most landlords prefer to have national chains and companies with locations and offices across the country. One of the jewelry store chains The Lease Coach works with has several hundred stores in 19 different countries with a strong presence and track record for both success and for paying percentage rent. The jewelry chain started with corporate stores and once success was imminent, they began franchising. As a landlord, you can see why this type of jewelry store concept may be preferable to a mom and pop operation or independent tenant.

Whether you're launching a new concept or copying a successful one is relevant to the landlord. Your business plan, your financial status, and your background are important to the landlord. If you're a respected mechanic with years of experience, you may be successful running an auto repair business because that business is one you know. But if you're a schoolteacher who suddenly receives a large inheritance, and can now quit your job and open the business you've always wanted — a personal fitness business, a cupcake shop, or a restaurant — the landlord may not be as certain about your future success.

Landlords love to lease space to national chains and franchisee tenants who have bought into large, proven franchise concepts. They really desire to lease space to healthcare tenants like dentists, doctors, and chiropractors. The doctors are professionals in their field who make for very stable and dependable rent paying long-term tenants.

If you know your tenancy or background isn't likely to look attractive to a landlord, then take heed and get better prepared. If you know you and your concept will be well received, then you're set. Some of the larger national landlords with hundreds of properties can likely size up any business concept or owner very quickly, so be prepared before you contact them. The first impression you make is a lasting one.

Leasing 101 for Tenants

Starting the leasing process in the right direction is critical if you want to achieve the best results. If you take the wrong path or veer off in the wrong direction, you may not achieve your goals or your business's full potential. That's how important the leasing process is. Errors, miscalculations, and bad advice at this stage can be difficult to fix later on.

To make the best leasing decisions, you need an inside and outside view of the different types of buildings or properties available (Chapter 3 can help you there). Then utilize a checklist to help you determine the pros and cons of different sites. The goal should be to lease the premises that will provide the most profit. On the surface, it seems that picking the best building would be advantageous; however, your particular business may not be able to afford or even justify paying the higher rents in more expensive properties. The last thing a tenant needs or wants is to find out that they've signed a long-term lease agreement in the wrong property. Chapter 4 can help you avoid this mistake.

During the initial leasing process, tenants invariably encounter and deal with commercial real estate brokers and their agents. We estimate that approximately 95 percent of all commercial real estate is listed with commercial brokers, so the chances of not dealing with one are slim indeed. Find out what the role of the real estate agent is, how to properly use a real estate agent, and how to conduct yourself in your dealings by studying the information in Chapter 5. Whether you're negotiating on shopping mall space, an office tower, industrial space, or a retail plaza location, it is necessary to navigate carefully as you negotiate with commercial real estate agents.

When it comes to negotiating a new lease or lease renewal, turning to professionals can save you time, aggravation, and money. Professionals you may choose to work with include a real estate agent, lawyer, or professional lease consultant. Investigating and evaluating the right professional to help you (the topic of Chapter 6) can be the difference between success and failure.

Negotiating the Offer and Key Terms

If you've never negotiated a commercial lease before, chances are you won't find this process easy or enjoyable. There's a steep learning curve when it comes to presenting lease terms and negotiating an offer to lease or letter of intent. Even if you have experience with hard negotiating, chances are you're not looking forward to locking horns with the landlord or their real estate agent — opponents who have experience on their side. This chapter explores ways to make you look and sound like a pro at the leasing table, even if you're a rookie.

Negotiating the business terms is one of the most critical aspects of the lease-negotiating process. The business terms include the rental rate, length of lease, deposit, personal guaranty, and a dozen other details that may not have occurred to you.

The rental rate is one of the most focused-on business terms, perhaps rightly so because it is one of the biggest factors determining the success or failure of your business. We look at how the landlord determines the rental rates, how to determine what you can afford to pay, and how to negotiate the best rental rate. The rental rate goes beyond one simple number — it can include additional rent often called operating costs and perhaps percentage rent, which can dramatically increase the total payment you make each month.

Knowing how important the rental rate you pay is, and that this number is calculated on a per square foot basis, means that understanding how much space to rent and how to calculate this size is crucial.

We also explore choosing the right commencement date — how to position yourself to take possession of the premises once the lease agreement has been signed by both parties. Traditionally, a tenant would spend one to three months building out their space prior to opening to the public. A lot can go wrong during that time. Tenants must know how to hold the landlord accountable and how to ensure and protect their rights in advance when the unexpected occurs.

Deposits are a misunderstood component of the leasing process. Many tenants are misled into believing that deposits are mandatory and pushed to provide larger deposits than may really be required or justified.

Reviewing the Formal Lease Agreement and Dealing with the Landlord

This part of the book deals with the remainder of the lease agreement — beyond the initial offer and key business terms — and discusses how to properly review and finalize the formal lease agreement.

Finalizing the formal lease agreement is a negotiation unto itself. Yes, the business terms have been agreed to, but now a 30-50 page formal lease document is looming and requires consideration. Understanding and negotiating the formal lease agreement should be done with the help of a professional — ideally, a lease consultant. Many clauses in the formal lease agreement require negotiation, amendments, or deletion. Adding certain phrases and clauses to the lease agreement also helps protect the tenant. Smart business owners realize that with any contract, it's better to be safe than sorry.

Dealing with the landlord and their representative, whether it's the property manager or a commercial real estate agent, is definitely a challenge. There are many different types of landlords with different motivations for owning property. Some landlords are billion-dollar corporations, and other landlords are small and accessible to a tenant. Understanding your opponent before you get into the ring makes a big difference in the outcome of your lease negotiation.

Negotiating Your Lease Renewal

Approximately two million commercial lease-renewal transactions take place every year in North America. Whether you're leasing space in a strip plaza, office building, shopping mall, or industrial warehouse, and whether you're a retailer, wholesaler, service provider, or healthcare professional, you eventually have to face a lease-renewal negotiation with the landlord. Once again, starting with the end goal in mind and planning far enough in advance, this process becomes easier, as we explain in Chapter 16.

Most landlords push for a rent increase on a tenant's lease renewal. This is normal and something you should anticipate. A lot can transpire in a 5- or 10-year lease term between when you moved in and when you need to negotiate your lease renewal. The lease-renewal negotiation is a familiar process to Dale and Jeff and gives these professional lease consultants an opportunity to re-address or fix a lot of the lease problems existing from the tenant's initial deal.

This part of the book also covers whether it is necessary to exercise the lease-renewal option clause, the best process for assigning your lease agreement if you're selling or buying a business, and how to prepare for the negotiating process. The difference between a rent increase or decrease on your lease renewal has lot to do with the homework you do and which professional helps you through the process.

The Lease Coach authors explain why many successful lease renewal negotiations include the return of the deposit to the tenant, removal of personal guaranties, and may also include leasing inducements and tenant incentives. Although you may not be able to pull this off on your own, experienced lease consultants like The Lease Coach specialize in negotiating lease-renewal rent reductions for all types of independent, franchise, healthcare, and office tenants. If you already own a business and desperately need a rent reduction on your lease renewal, pay special attention to this section.

The Part of Tens

In the Part of Tens portion of the book, we hope to throw some bite-sized nuggets your way that are both easy to understand and fun to discover. Turn to Chapter 18 for leasing tips, tactics, and strategies for tenants. In Chapter 19, we provide an easy checklist of ten questions to ask the landlord's real estate agent on prospective locations.. We also include ten or so warnings for tenants to heed in Chapter 20; these warnings will help you avoid leasing pitfalls and confrontations when dealing with your landlord.

The authors of this book welcome your comments and questions by e-mail or phone (see "About the Authors"). If you have a great leasing story to share or even a nightmare experience, we want to hear it.