

HOW TO NEGOTIATE A LEASE LIKE A PRO

Information equals leverage when negotiating a lease.

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TRICKS OF THE TRADE is a monthly column where shop owners or noted experts share their opinions and advice on store-management issues. To suggest topics you'd like covered, send an e-mail to: sean@twonet.com

The other week, Tony Hawk appeared on *Celebrity Poker Showdown* to raise money for his foundation and was knocked out early by none other than Dennis Rodman. Negotiating a real-estate deal is much like the game of poker: if you show your cards or react abnormally, your opponent will have the upper hand. Unfortunately for Hawk, Rodman reacted strangely on every hand, forcing the Birdman to go "all in" on a hand when Rodman ultimately held better cards.

As an owner or decision maker at your company, how do you play your cards to an existing or potential landlord? A ton of questions arise when faced with the prospect of leasing a new space: Where should I operate? How long should I commit? How much should I pay? Will the landlord build a mini ramp for me? Can I get in early to set up shop? Will I get screwed at the end of my lease if I want to stay? Finally, do I have to go it alone?

WHERE SHOULD I OPERATE?

Whether you're a retailer like Sun Diego with a need for a high-visibility location with easy access or a distributor like Earth Products or Podium requiring a location with truck access and proximity to freeways, location is the most important aspect of your property search. In order to succeed, your company must adhere to the three unwavering rules in real estate: location, location, location.

Several years ago, a now defunct snowboard binding company named Belligerent decided to run its assembly operation out of a retail location in the Pacific Beach area of San Diego just two blocks from the ocean. It seemed like a good idea to the owners because most of their employees lived in the area and could skate or ride their beach cruisers to work. Employees could even surf on their lunch break. This would generate high employee morale, which would lead to a boost in productivity. So they thought.

Many surf-, snow-, wake-, and skateboard-related companies have fallen into this trap. Since Belligerent wasn't retailing its bindings and didn't require a high-visibility location with plenty of customer traffic, it didn't gain the real benefit of the location. The company employees could have driven east to Kearny Mesa, Mission Gorge, or even El Cajon where industrial rents were well below what Belligerent was paying for the retail location.

The location of your operation can make or break your company. In the case of Belligerent, expenses exceeded revenue and ultimately broke the brand.

HOW LONG SHOULD I COMMIT?

A key element in the negotiation process is the length of your lease. How long of a lease should your company commit to? The answer depends on your growth strategy, ability to justify the cost, and downtime involved with a move.

For a retailer or a private skatepark, it may make more sense to negotiate a longer-term lease since these types of companies will likely stay in a space for many years to come. Landlords, however, sometimes prefer to negotiate shorter leases with these types of companies so they can jack up the rates when the company gets entrenched or dependent on its location, thus becoming a captive audience. The best course of action to take when this situation arises will be covered in the "Renewing Your Lease" section.

Distributors, wholesalers, and manufacturers—especially during the first few years of existence—may easily grow too large for a space in two to three years. These types of companies should negotiate shorter-term leases so they have the flexibility to grow or contract. As flexibility rises, however, leverage or negotiating power is depleted. Most landlords won't budge on the rate of a short-term lease, and some may even charge a premium.

Note that some landlords own several business parks and are more than happy to accommodate a tenant's growth within their portfolio assuming the company is

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consistently paying the rent on time and not causing a nuisance to the neighbors. It's important to find out the landlord's stance on accommodating growth, as well as the rules associated with subleasing or assigning your lease before entering into the lease. Terms such as "first right of offer" and "first right of refusal" on adjacent space can come into play, but typically require a long-term commitment, outstanding company credit, and some crafty negotiating.

There's also a way to hedge your expansion by skillfully negotiating a long-term lease with a low start rate and higher-than-normal annual increases on a space that you plan to grow into by the second or third year of your lease. Most landlords are reluctant to agree to this since the risk of not recouping their investment and the danger of



the company bailing—going bankrupt—in this situation is extremely high. This is especially true if the landlord spends any money on tenant improvements or if the company is relatively young.

HOW MUCH SHOULD I PAY?

After your broker provides you with information in the form of a survey of spaces that meet your operational needs and educates you on the economic possibilities of each location, you must decide what you're willing to pay over the next few years. This can be difficult to determine, but extremely significant. The reality is that you'll probably have to pay more than you prefer, but things will operate more efficiently if you plug realistic numbers into your budget.

In order to determine your budget, you must analyze your business plan. Based on the best-case scenario, how much revenue do you expect to generate over the next few years? Based on the worst-case scenario, how much revenue do you expect to generate over the next few years? What other expenses will come into play? Payroll, taxes, insurance—including workers comp and liability—cost of goods sold, unsold inventory, employee training, benefits, advertising, initial setup or moving costs, and dollars allocated to reinvestment in the company are all factors that must be considered.

If the budgeted rental payment that you determined isn't even close to any of the rents of alternative properties listed on the survey, you should reconsider your strategy. It may be necessary to revisit your size, location, and image requirements as rents vary widely based on these factors. You may also want to reconsider spending thousands of dollars on that sick mini ramp or bowl in the back of your store. Do you really need pool coping on the tombstone? If you land the best possible deal on a place that fits you like a glove but still feel overextended after evaluating your other expenses and business plan, don't sign the lease.

Keep in mind that you'll be responsible to pay a security deposit unless you're a Quiksilver-sized company. The amount will depend on the creditworthiness of your company. If you're a new company, the amount of the deposit depends on the creditworthiness of the principals (you and your partners) who'll likely have to personally guarantee the lease.

Be aware that you'll also be responsible for other expenses related to your space. Depending on your rent structure, these can include property taxes, property insurance, utilities—including telephone, electric, and Internet services—and common-area maintenance, which includes but is not limited to landscaping, parking-lot sweeping, common-area lighting, trash pickup, water, and property management fees.

Also, note that the negotiated rental rate is merely the rate for the first year of the lease with annual escalations thereafter. These increases typically range from three to four percent or in some cases are tied to an index such as the Consumer Price Index (CPI). Be wary of percentage rent clauses, which tie the rent to in-store sales on some retail leases.

WILL THE LANDLORD BUILD A MINI RAMP FOR ME?

Are your improvements marketable or reusable to the next tenant down the line? This is the question that landlords will ask themselves before spending any dough on new tenant improvements or modifications to the space, including demolition of existing improvements. In a retail location, your new counter area and dressing rooms, for example, may be reusable if located logically in the space. In an office or industrial location, offices that are built too large (twenty by twenty) or too small (eight feet square) may not be marketable for the next tenant. Unfortunately, mini ramps are never included as reusable improvements.

continued on page 128

continued from page 126

Even if your proposed improvements are marketable and reusable, there's no guarantee that a landlord will perform them. Most landlords will provide new paint and carpet, depending on the existing condition of the space. If the space is highly dysfunctional, or on the market for six months or longer, the landlord may provide a tenant improvement allowance to pay for the demolition of existing walls or the construction of new walls.

Negotiating a lease is indeed like a game of poker. By bringing in an expert who's familiar with how these landlords deal and how the market conditions relate to the game, the landlord's cards can become more transparent and your play will be enhanced greatly.

In other cases, the landlord may be willing to amortize the cost of improvements into the lease. It's up to you and your broker to compel the landlord to provide as much as possible in the way of improvements. Keep in mind that plumbing and air-conditioning modifications can be prohibitively expensive.

Taking the space in "as is" condition can be a great way to save money and move in sooner. In many cases, since the landlord expects to have to pay for some degree of tenant improvements, they'll give you a discount or concession to take the space "as is." Even if you take the space in "as is" condition, the landlord will typically ensure that all mechanical, plumbing, HVAC, electrical, ceiling tiles, lights and covers, and ceiling grid work are in good working order and condition as of the commencement of the lease.

Although the landlord is likely to have his own contractor who performs most of the work around the project, it can be advantageous to use your own—as long as you have a reputable contractor that doesn't charge too much. The contractor that you use must be licensed, bonded, and approved by the landlord.

CAN I GET IN EARLY TO SET UP SHOP?

It's reasonable to expect a short period of early occupancy for move-in, fixturing, and the set up of your space. If you take the space "as is," you can get in upon delivery of first month's rent, security deposit, certificate of liability insurance (evidencing coverage of your company as well as the landlord), and the full execution of lease documents.

You can begin negotiating on several spaces up to three months prior to your lease expiration or anticipated start date. If no other parties are interested in the space, or if the space has been on the market for quite some time, the landlord will want to start moving forward on a lease. If you push them, they'll likely grant early occupancy upon full execution of the lease document or upon substantial completion of tenant improvements, if applicable.

WILL I GET SCREWED AT THE END OF MY LEASE IF I WANT TO STAY?

If your existing landlord believes that you have no other options besides renewing with them, you'll get screwed. Your landlord is in the business of collecting the highest rents possible. You must have options.

Even if you're planning on renewing your lease, it's important to identify alternatives. The more you know about other alternative spaces, as well as the landlord's current vacancy situation, the more leverage you have.

Let your existing landlord know that you're looking at alternatives. Remind them that if you move out, they'll be faced with a ton of expenses including new paint, carpet, brokerage commissions, marketing costs, and downtime. These can be significant depending on the market conditions and the time necessary to bring the space back to a market-ready condition.

DO I HAVE TO GO IT ALONE?

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Negotiating a lease can be a daunting task. Landlords will do everything they can to achieve the highest rent possible while giving up or spending as little as possible. That is, of course, how they make their livings and you should not blame or disrespect them for that.

THE BOTTOM LINE

Negotiating a real-estate lease can be extremely frustrating and time-consuming. To minimize the hassles, consider the following when facing the prospect of moving:

- 1 The location of your operation can make or break your company.
- 2 The length of lease that your company should commit to depends on your growth strategy and your ability to justify the cost and downtime involved with a move.
- 3 The reality is that you'll probably have to pay more than you prefer to pay, but will still operate efficiently if you plug realistic numbers into your budget.
- 4 Even if your improvements are marketable or reusable to the next tenant down the line, there's no guarantee that the landlord will pay for them.
- 5 It's reasonable to expect a short period of early occupancy for move-in, fixturing, and to set up of your space.
- 6 If your existing landlord believes you have no other options besides renewing your lease with them, you'll get screwed. You must have options.
- 7 Choose a broker who's fully aware of the commercial real-estate market and understands your specific business and industry.
- 8 The more information that you know about your potential landlord and their property, the more likely you'll get the best deal possible.

You should, however, fight back. But keep in mind that establishing a healthy, long-term relationship with your landlord is crucial. A high-quality broker can negotiate fiercely on your behalf while keeping you in good graces with the landlord.

After deciding what type of space and location serves your use best and narrowing down your search to a few submarkets or geographic areas, you should get in touch with a reputable real-estate broker. Choose a broker who's fully aware of the commercial real estate market and understands your specific business and industry. There are far too many brokers out there who think of snowboards, skateboards, and surfboards as silly toys and have no clue about your industry.

Your broker should uncover every space that meets your needs, advise you on important property related concerns, and negotiate professionally on your behalf.

The most successful real-estate brokers treat every negotiation as if they have a stake in the client they're working on behalf of and strive to promote a long-term relationship. In addition, they should have resources to deliver the best service and information necessary to negotiate the fairest deal possible.

By company resources, I mean research and support. For example, CB Richard Ellis is the world's largest commercial real estate services company and has more than 17,000 employees in 50 countries. It converts data collected from proprietary research and purchased from vendors into market knowledge by organizing it into easily accessible databases and performing

in-depth analyses based on historic and current data that their brokers can use. This mumbo jumbo translates into transparent cards in the hands of landlords. The more you know about your potential landlords and their properties, including past transactions, current vacancy, and even future lease expirations of tenants within their project, the more likely you'll get the best deal possible.

Incidentally, since the landlord is responsible for payment of brokerage fees, you can only save money by enlisting the help of a quality commercial real estate broker.

Even with the best broker, you must possess reasonable expectations based on market conditions and existing demand. A high-quality broker will educate you fully on these items and strive to prevent unnecessary surprises.

Tricks Of The Trade is brought to you by the Board Retailers Association to help educate retailers across the country. The Board Retailers Association was formed to help boardsports retailers in a variety of ways: to give its members group discounts, to provide a unified voice to manufacturers, to help promote consumer awareness and shopping at boardsports retailers, and to help educate boardsports retailers.

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