



A BETTER PROPERTY LEASE

BY PHILLIP M. PERRY

So your property lease is up for renewal. Well, polish your reading glasses and sharpen your pencils: It's time to fine-tune the fine print to get more favorable terms. Rent, after all, is one of your biggest expenses. In these times of lower expectations for revenue increases, it makes sense to fatten your profit by paring your overhead. "Many people believe that if their space needs are being met, come renewal time they should just sign on the bottom line," says Myra Maher-Martin, vice president of Joe Foster Company, a Dallas-based real estate brokerage and advisory services company operating nationwide. "Strategically, that is not in their best interests." The problem, says Martin, is that landlords often have creative ideas about modifying lease terms. "If landlords are going to try to obtain more favorable terms, tenants should do the same," says Martin.

HERE'S SOME GOOD NEWS:

You now have more leverage for negotiating favorable terms. That's because more business property has come onto the market. With the current softening of the economy, more businesses have either closed shop or put expansion plans on hold. "National statistics show that there is a slightly higher vacancy rate in many markets," says Bob Wiesner, senior partner at The Robert Thomas Group, a Chicago-based real estate lease auditing firm. "That means rents will either stabilize or come down a bit. Furthermore, tenants will have a little more negotiating power in terms beyond base rent."

Many factors, including shocks to regional industries and commercial property overbuilding, can contribute to sudden market changes. "When the dotcoms crashed, for example, parts of San Francisco suddenly went from one of the nation's tightest property markets to one of the softest," says Maura Cochran, president of Bartram & Cochran, real estate and economic development consultants in Hartford. "Silicon Valley is vastly overbuilt."

Lesson learned: Space availability will vary by city and neighborhood. Prior to developing a lease renewal strategy, find out what's happening in your area. "You need to know if you are in a market that has become stronger or weaker," says Cochran. "Talk with real estate brokers in your town." (Many brokers, adds Cochran, publish current market analyses on their web sites.) "As a general rule, if a market has more than seven percent vacancy it is considered a tenant's market," with a requisite improvement in negotiating power.

Even if your lease has some time to run, you may want to negotiate an extension now. Given the economic storm clouds on the horizon, your landlord may jump at the chance for shelter in the form of a proven tenant. Fact is, the landlord will benefit in many ways if you continue your lease. For starters, there will be no costly unrented time while a new tenant is located, and no expensive fixing up and painting of your premises. "You don't have to wait until your lease is up for renewal," says Susan Hays, a principal with the Hartford-based law firm of Updike, Kelly and Spellacy. "If you are midway through your lease and you are happy, negotiate an extension now."

In general, be smart and negotiate early. If you wait until the last minute, your landlord may try some delaying tactics, which can eventually cause you to sign a poorly examined document when moving to new quarters is no longer an option. "Some landlords will string along tenants until they don't have time to move," warns Mark Fajack, a vice president at Cost Analysis Management Co. (CAMCO), Cincinnati. "So start a year in advance."

Many tenants get outside assistance from specialists who know leases inside and out. These may be brokers, attorneys, or specialized firms that do nothing but lease negotiations and audits (see sidebar *Getting some help*)

OK, you want to improve the terms of your lease. But there's an awful lot of fine print to go through, and you have limited time. What areas should you target? Here are 12 steps to a better deal, as suggested by our experts:

1 Check the terms of your renewal options

Does your lease provide for a renewal option? This is the first thing to find out. If you have already renewed your lease once, there may be

no additional automatic options left, which can pose problems.

"Sometimes people negotiate better renewal option terms," says Hays. "They may say, 'I would like a five-year lease and the option to renew for an additional two five years periods.' If they have a really good site, this is a way to lock the landlord into allowing them to stay longer."

Landlords would rather have a single 10-year lease than one 5-year one with an option to renew, points out Hays. However, they may agree to options if you will guarantee escalators in terms of rental amounts. As with any other lease negotiation detail, options are matters of give and take.

Pay attention to the time frame in the renewal option. Be aware of any demands that you notify your landlord of intent to renew before a certain number of months prior to lease expiration.

2 Find a "walk-away alternative" before negotiating

If you are going to negotiate from a position of strength, you need to know you can walk away from your current position because you have an alternative location to fall back on. "Few tenants take time to get a walk away alternative," says Martin. "But it's crucial." Besides leverage, there's another benefit to having an alternative location: you can visualize your negotiation as an entirely new piece of business rather than an alteration of a previous agreement. "You want to consider every critical term of your lease a negotiable item," says Martin.

One final point: Don't try to fake your walk-away alternative. You must always have a real one for it to work, or otherwise you will pull your punches during negotiations, says Martin.

3 Watch for unfair escalation clauses

Outside of the base rental rate, the stickiest part of a lease is the operating expense escalation clause. Sometimes called "pass through claus-

es," these call for your rent to increase according to a formula that determines your pro-rated share of the actual rises in a building's operating expenses.

Unfortunately, such clauses often include so many types of operating expenses that they result in unexpected liabilities for tenants. Many landlords view these clauses as profit centers while tenants see them as methods used by landlords to stay even. In your negotiations, attempt to eliminate expenses that relate to the risks of ownership rather than of leasing. These include marketing costs for the building, and amortization of maintenance and energy conservation and cleaning equipment. Capital improvements to the elevators and other building systems should be amortized rather than expensed directly. Also watch for landlords who manage more than one building but assess all of their overhead expenses to the tenants of one building.

Back in the days of high inflation, the escalation rate was tied to the con-

sumer price index (CPI). In those days, tenants would attempt to put a "cap" on the increases to lessen risk. While we don't see such rapid price hikes anymore, sometimes rent increases are still tied to a CPI escalator formula. "You should examine the terms that apply in your lease," says Hays. "Many leases will simply say that the rent will increase by a certain amount each year, say five percent."

Whatever the escalation terms, both sides are attempting to limit risk. If your lease calls for five percent increases during renewals, you may end up paying more or less than the going rate for similar properties, depending on what conditions are affecting your market.

4 Obtain "finish allowances"

Your property has undergone some wear and tear over the years and could use a face lift. What kind of money will the landlord devote to this purpose? "The landlord will have bud-

geted some money to fix up your space in the event you decided to leave," says Martin. "How much of that money can you obtain for repainting and re-finishing?"

Says Fajack: "Try to get some repair and maintenance of your interior space, including paint and carpeting and ceiling tiles."

5 Change base year to the current year

Here's another tip that relates to operating expenses. Operating expense escalation rates replicate the increases in such costs over a "base year," which is generally the year your lease began. "When you do renew, make sure the base year is adjusted to the current year, rather than to some former date," says Fajack.

6 Beware a change from gross lease to net lease

In a "gross lease," the landlord bears all of the risk for repairs and main-

GETTING SOME HELP

Some lease renewal time, business owners often turn to their brokers for advice. And that can be smart, since landlords will often avoid proposing questionable terms when they know experts will be perusing the fine print. "Just the fact that you have a broker will encourage your landlord to offer a better deal," says Myra Maher-Martin, vice president of Joe Foster Company, a Dallas-based real estate brokerage and advisory services company.

Prior to deciding on a broker, ask for references in terms of current clients, suggests Martin. Then get feedback from the references. Did the broker pursue better lease terms tenaciously? Bring in a lease that was "on budget" in terms of your current needs? Complete the work on time? And how well has the broker's lease withstood the slow erosion by operating expense pass through's?

Be aware there are two types of brokers: "tenant" and "landlord." The latter represents space marketed by prop-

erty owners, so there can be a conflict of interest when it comes to lease terms. It's smarter to use a "tenant broker," who represent tenants exclusively.

You may also seek the help of a consultant who specializes in property leases. One good source of experts is the membership list of The Counselors of Real Estate (CRE), comprised of real estate, financial, legal and accounting firms who specialize in property lease negotiations. The CRE is at 430 North Michigan Ave., Chicago, IL, 60611. 312/329-8427. You can search for consultants in your region, on the web at www.cre.org.

Looking for more detail on the fine points of the fine print? A number of white papers on the most critical areas of property leases are posted on the web at www.rentaudit.com, the web site of The Robert Thomas Group, a Chicago-based real estate lease auditing firm. Another good reference site is at www.leasesmart.com, maintained by ITRA Palm Beach, a tenant representation company in Stuart, FL.

tenance. In a "net lease," the tenant pays for a portion. Know which kind of lease you have. And beware an unannounced change in the lease that can leave you liable for thousands of dollars in additional expense.

"One Michigan business signed a lease renewal that provided for a mod-

case law has developed over the years that a tenant has a right to see what they are paying for."

Wiesner advises against signing leases that are overly restrictive in terms of audit rights. "A lease may state that operating expenses must be audited within 10 days of the issuance

takenly do so, do not waive your right for reimbursement later.

9 Restrictive sublease clauses

Try to preserve your right to sublease space without your land-

the monthly rent.

"Don't let the landlord get the upper hand on holdovers," says Martin. "You may be held liable for the landlord's loss of another tenant. Make sure you use a broker who is knowledgeable about the correct lease language."

11 Original condition clauses

Some leases contain language that requires you to leave the premises in their "original condition" when you depart. Try to get this term defined specifically so you are not penalized for normal wear and tear. And have a dollar limit placed on the value of any required restoration. Another smart move is to take some photos of the premises when you move in, so you have evidence of any pre-existing conditions that were not of your making.

12 Eliminate personal guarantees

Maybe when your business was young, your landlord would not offer a lease without a personal guarantee. Times have changed, now that you have proven yourself. "It's easy to forget the existence of these guarantees, and that you are now exposed for more money because the rent has gone up," says Martin. "Negotiate out the clause."

The tips in this article will help you negotiate more profitable conditions come lease renewal time. Plan ahead. Thoroughly analyze your contract, and don't sign on the bottom line until you get the best deal possible.

The net result of all this negotiation will more profit for you, since excess rent and expense payments will not erode your bottom line. Your landlord, too, will be better off with a happy tenant who decides to stay for the long term rather than look for better conditions elsewhere.

"The best lease," concludes Martin, "is win-win for everyone."

Phillip M. Perry is a free-lance business writer based in New York City.

YOUR LANDLORD WILL BE BETTER OFF WITH A HAPPY TENANT WHO DECIDES TO STAY FOR THE LONG TERM RATHER THAN LOOK FOR BETTER CONDITIONS ELSEWHERE.

est rental increase to \$17,000 a year," says Fajack. "But the landlord didn't mention the contract was changing to a net lease. As a result, the business is paying \$5,000 more than anticipated." You can avoid similar bad news by making sure you are not switched out of a gross lease unannounced.

7 Assure your right to audit operating expenses

So you've agreed to pay a portion of the operating expenses for your property. But how can you make sure the numbers from your landlord are accurate? Answer: Make sure your lease contains language that allows you to audit bills in a timely fashion.

You want to be able to audit these expenses, because in some cases they can add up to 30 to 40 percent of your total rent. Such expenses may include janitorial expenses, insurance, administrative costs to run the building, electricity and other utilities, real estate taxes and a host of other line items. "Given the variety of what may be included, it's important to negotiate a lease that itemizes exactly what you will be paying for," says Wiesner. "And many leases will contain explicit language that permits the tenant to audit the operating expenses. Sometimes leases are silent on the subject, and in those cases we believe enough

of a statement," he says. "We find this is impractical for most tenants." What time frame should you negotiate? "I wouldn't sign anything for under three months, and I think three years is reasonable," says Wiesner.

8 Don't waive your right to obtain money due

As part of your renewal, you may be asked to sign an attachment to the effect that the landlord does not owe you any money. "If signed improperly, this can hurt you," warns Wiesner. "I've seen cases where landlords have owed tenants money that has been waived away."

Prior to signing, perform due diligence to make sure you are not owed anything. Some categories to watch, says Wiesner: overpayments on prior leases, tenant improvement allowances, and rebates or free rent with your previous lease. The "free rent" amounts can be easy to overlook if the specified months are staggered. For example, suppose your landlord had originally sweetened a five-year lease offer by specifying two months free of charge. At the same time, though, the landlord assured that you would stay for the long term by assigning those rent-free periods as months 36 and 37. It's up to you to make sure you do not pay for those months, or, if you mis-

lord's written consent. If your landlord insists on the right to approve sub-tenants, try to limit the time allowed to reach a decision to 30 days or so. Some leases allow the landlord 90 days to approve a sublease. In that time, the sublessor will have long since decided to rent some other space.

10 Beware holdover clauses

Suppose that you are unable to move to your new location smoothly and on time. This condition, called a "holdover," may have come about through no fault of your own. All of the moving companies, for example, could go on strike before moving day. If your lease calls for onerous payments to the landlord in such a case, your profits could be hit hard.

Some contracts go so far as to stipulate that the tenant pay double the monthly rent, as well as damages to the landlord. Suppose another tenant cannot move in on time because you have not moved out, and that as a result the tenant cancels the lease. Damages to the landlord could be deemed to be very high and you will be liable if the contract so states. Get any such clause out of the contract. Alternatively, you may be able to get the penalty reduced to 125 percent of

AFFORDABLE SOLUTIONS

COMPLETE POINT-OF-SALE SOFTWARE FOR RENTAL AND RETAIL STORES ONLY



\$899.00

RTO PRO INCLUDES:

Complete inventory, including depreciation
Retail sales ✕ Complete rental
Collection and overdue reports and on-screen account
Management ✕ Billing ✕ Airtime accounts
Contract printing ✕ Cash-advance transactions
Data conversions from other software available

Windows 95, 98, NT and network versions

HOME OFFICE NOW AVAILABLE!

FREE DEMO AVAILABLE. CALL [800] 351-6299,
OR VISIT OUR WEB SITE AT WWW.RTOPRO.COM FOR MORE
INFORMATION AND TO DOWNLOAD THE DEMO.

FUTUREWARE ENTERPRISES INC.
5026 Gall Blvd., Zephyrhills, Florida 33541



APRO Associate Member since 2000



What's on your mind?

IF IT'S RENTAL-PURCHASE,
WE'RE YOUR LINK



Visit www.apro-rto.com for the latest information on the RTO industry and the Association of Progressive Rental Organizations. Our dot-com features updates on legislative action, APRO events, convention details, a virtual trade show, financial statistics and late-breaking news.

Click our way today.

www.apro-rto.com