

When the Landlord Says No! How to Negotiate Favorable Lease Terms and Conditions

by Stephen A. Cross, CCIM



Seasoned negotiators understand that hearing a “no” simply means you haven’t given the other party enough good reasons to say “yes.” And getting to “yes” in commercial real estate negotiations is best accomplished by *preemptively*

identifying circumstances and market conditions landlords know to be true (although they may be hesitant to acknowledge); and basing your proposed terms and conditions on these factors.

This discussion will identify the most common variables that have a direct impact on your businesses’ overall occupancy costs; and the strategies I use when negotiating the lowest price, best terms and most favorable conditions for my clients.

Lease Term

The length of the lease is the foundation for all negotiations, and ultimately determines the economics of the transaction. That’s because property owners need sufficient time to recoup the value of concessions or contributions made to obtain a tenant.

Generally, greater incentives and concessions can be expected with a longer lease term; and can include free rent, a reduced rental rate, as well as additional contributions from the landlord to improve the space. However, at some point longer lease terms yield no additional incentives. *Strategy:* Negotiate the shortest lease term that will enable you to extract the maximum concessions. Accomplish longer lease terms through renewal options, which provide flexibility and the opportunity to negotiate additional concessions as the market changes.

Occupancy Date vs. Commencement Date

The occupancy date is the date you can move into the premises. The commencement date is the date that rent, or any free rent period, begins. Both dates are negotiable. *Strategy:* As landlords prefer the shortest possible vacancy period, time your occupancy to be as close to the availability date as practical. Note that I do not suggest paying rent based on the occupancy date...merely taking delivery of the improved space earlier, rather than later. While some landlords bristle at granting a period of free rent, most will grant an “early occupancy” period at no charge. If you’re in the space but not paying rent ... it’s free.

Free Rent

Savvy tenants are generally able to negotiate a period of free rent, which serves to effectively reduce the rental rate set forth in the contract. Achieving one month of free rent for every year of the proposed lease term lowers the overall rental rate by 8.33%. For example, on a lease with a “contract” rate of \$ 24 per square foot, this results in a savings of \$2 per square foot, yielding an “effective” rate of \$ 22 per square foot. *Strategy:* If a space is vacant anyway, free rent is a concession that will cost the landlord nothing. As a result, many landlords are willing to grant generous free rent periods in order to keep contract rates, and occupancy levels, high. Also, insist that any operational expenses (commonly known as NNN, or Triple Net expenses) are waived during the free rent period.

Base Rental Amount

The asking rate, otherwise known as “market rate”, is nothing more than the landlord’s target rental amount, and is based on the landlord’s perception of the highest price an uninformed, unrepresented or under-represented tenant will pay. However, no one, including the property owner or its agents and brokers, reasonably expects to achieve it. Therefore, the asking rate is analogous to the sticker price for a car...merely the starting point of the negotiation. *Strategy:* A good rule of thumb is to offer no more than 80% of the asking price. Note: Under-representation occurs when a listing agent, or more than one agent from the same

company, represents both landlord *and* tenant in the same transaction, creating a dual agency. This arrangement *always* favors the landlord and should be avoided.

Escalations

Question: Where is it written that rents need to increase every year?

Answer: Only in the landlord’s playbook. Therefore, keep escalations infrequent (if at all) and to a minimum. Also, there is nothing sacred about increases tied to the change in the Consumer Price Index (CPI), which has been increasing approximately 3% annually over the last few years. Landlords contend that rents should increase with inflation ... but their mortgage is probably fixed; and your ability to increase prices may be limited. *Strategy:* When escalations are absolutely required, first negotiate a nominal, fixed amount; that failing, place a ceiling on any increases.

Tenant Improvement (T.I.) Allowance

Office and industrial spaces should be delivered in a “turn-key” condition. Retail leases generally carry a T.I. allowance of between \$ 5 and \$50 per square foot, depending on whether the space is in “vanilla” or “grey” shell condition. *Strategy:* Help the landlord make the decision by agreeing to a configuration that will have good second generation value; that is, be useable to the next tenant.

Fixturation Period

If you are performing your own improvements, keep in mind that it will take at least 45-60 days to obtain building permits, *plus* an additional 45-60 days to build out the space. *Strategy:* Negotiate a fixturation period of 90-120 days from the date the space is delivered free of Base Rent and Triple Net expenses. Completing the build out before this period expires has the effect of creating additional free rent.

HVAC

In full service leases, the landlord maintains and repairs the heating and air conditioning systems. This is not the case in Triple Net leases, which are common in retail and industrial transactions. Request that the landlord warrant the HVAC systems for the entire period of your tenancy, including any exercised option periods. *Strategy:* If a full term warranty is not possible, negotiate an annual cap on the tenant’s out-of-pocket expenses; \$ 300 to \$ 500 per year is reasonable.

Prohibited Uses

Outside of exclusive uses, which protect existing tenants from direct competition, a landlord may occasionally say that a perfectly legal use (for example, a dance studio) is prohibited in the center. This is commonly due to a concern by major tenants that certain uses could adversely affect their parking. Therefore, you (or your real estate advisor) should contact the major tenants and plead your case. Grocers routinely negotiate protections that prohibit any use that could otherwise impede their customers’ ability to get to their front doors; it’s a convenience issue. If it can be demonstrated that your use does not compete for parking spaces there is a strong likelihood the needed accommodation can be obtained. The approval will be conditional and must be in writing.

Closing Comments

Before any landlords “no” you, make certain they know you’ve done your homework; and that you understand the true state of the market, the many variables that can be negotiated, and have identified alternative buildings ... the owners of which would welcome the opportunity to compete for your tenancy. Always remember, the last thing a landlord wants to hear you say is “No, I’ve leased space elsewhere.”

Stephen A. Cross, CCIM owns CROSS Commercial Realty Advisors and counsels business owners, facility executives and corporate decision-makers on ways to acquire or lease property at the lowest cost and most favorable terms. Please contact him at (480) 998-7998 or steve@crossrealty.com.