

TOP 10 LEASE NEGOTIATION & SITE SELECTION MISTAKES

Survey of Corporate Real Estate Users

Compiled by Michael Coretz

Dear Friends & Valued Clients,

We have prepared the following material and forms to help take the mystery out of site selection and lease negotiations. We hope you find it interesting and useful. Additional information tips can be found on my blog website: www.cretucson.com

Sincerely,

Michael Coretz

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The following list of common mistakes is the result of a survey taken among members of the prestigious International Tenant Representative Alliance. Participants drew from an average of well over 15 years of Tenant Representation experience, representing and advising national and local commercial tenants with hundreds of leases totaling millions of square feet. Most major U.S. markets were included.

The **main risks** to consider when commencing the Facilities Acquisition Process (Lease or Purchase) can be broken down to the following three categories:

MONEY – Were the best possible rate and terms achieved?

RISK – This includes the risk of making a bad location or operational decision, and whether you have the right lease clauses, which prepare for future, unknowable requirements such as business expansion, contraction or relocation needs.

TIME – How much time is going to be spent on the Facilities Search and Acquisition process, and what will it cost the company in terms of lost productivity?

Information in this guide will eliminate or reduce these issues!



#1 Most Common Mistake: **NOT ALLOWING ENOUGH TIME**

Facility research, property inspections and comparison analysis can usually be completed in a week or so by motivated companies already familiar with the local market. However, those tasks are only the tip of the “time drain” iceberg, and several commonly overlooked complications needing to be factored into the relocation timeline:*

- 1) Negotiations with the Landlord and preparation of the lease can take weeks, (even months).
- 2) Once the Lease is signed the interior usually needs to be finished or renovated, which can take one to two months.
- 3) Before renovations can begin, building permits need to be obtained which can take one to two months, and
- 4) Before permits can be obtained, architectural plans must be completed, and may take one to two months.

If existing facilities cannot be found which are acceptable, new construction can easily take 9 to 12 months or longer.

Bottom line: 6 - 12 months is a good time frame to use when looking for new facilities, even longer if experienced professionals are not used to guide the process.

* This assumes the space is not going to be taken as-is, which is possible, but unlikely.



#2nd Most Common Mistake: NEGLECTING LONG-TERM PRIORITIES

Owners who think only about solving immediate needs face expansion problems very soon again! In addition to evaluating short term needs relative to square footage requirements (number and size of rooms), type of floor plan (open, private, or a mixture), communications needs, parking needs, access and security needs, etc., be sure to factor in long term needs. By obtaining facilities and lease terms which will allow the company to expand, downsize or relocate as circumstances dictate, business owners can avoid the unnecessary headaches, loss of business and costs associated with relocating. Examples of such important lease clauses include:

- Expansion right obligates the Landlord to provide Tenant with more space should it become necessary.
- Cancellation right (commonly referred to as a “kick-out” clause) allows the Tenant to break the lease under certain conditions such as when the Tenant needs to expand and the Landlord cannot provide them additional space on the premises.
- Extension right is similar to an option, and allows the Tenant to remain in the premises (a right of first refusal is a type of extension right).
- Sublet right gives the Tenant flexibility in that if it must relocate, it may sublease the space and mitigate the economic pressure.

Suggestion: After discussing the company's immediate needs and long terms goals with senior management in all departments, meet with leasing experts and space planners/architects to determine a) the most productive combination of office size and layouts (modular furniture, hoteling, size, amenity requirements, etc.), b) facilities which are flexible enough to service future needs, and c) certain lease clauses which will be negotiated into the lease document..



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3rd Most Common Mistake: INADEQUATE REPRESENTATION

Unless someone in the company is already an expert in commercial real estate, most business owners cannot afford the time necessary to learn this complicated industry. Lack of knowledge combined with time pressures can cause unrepresented owners to a) make location decisions without being aware of ALL the choices, and b) make costly errors that cut into their profits and increase their financial exposure.

An experienced and specialized Tenant Rep counterbalances the Landlord's professionals, and will insure that the Tenant receives the best possible rates, terms, incentives and lease clause protections. Incredibly, this valuable service may cost the business owner nothing, since Tenant Reps usually share in the Leasing fees paid by the Landlord.

Using the wrong broker may lead to incomplete information, or conflicting loyalties because of hidden agendas or Landlord relationships.

Note: *Business owners who do not use a Broker will likely not be aware of all the possible facility choices. This is because an experienced Tenant-Rep broker has developed an extensive network, and commonly finds facility choices which are not yet vacant or on the market.*

Suggestion: *Tenants should also keep their broker involved in the expansions, contractions, renewals and extensions that occur during the lease to prevent uninformed decisions that lead to lost opportunities.*



4th Most Common Mistake: LEASE COMMENCEMENT DATE IS NOT TIED TO BUILDING COMPLETION

This has been a disaster for many inexperienced Tenants who found that unexpected delays in the planning, permitting and construction stages ate into their rent-free build-out period and caused budget nightmares.

Suggestion: *Tenants should always propose a clause to the lease which provides for an extension of the lease commencement date if pre-opening delays are encountered which are beyond the control of the Tenant. Your professional can suggest some good lease language.*





5th Most Common Mistake: UNDERESTIMATING THE CONDITION OF THE PREMISES

Tenants who take a property “as-is” put themselves at great risk. Even when the space looks fine and has been previously occupied, building codes may have changed or the unit’s infrastructure may be broken or inadequate.

Suggestion: *It is best to have the Landlord guaranty the space is up to current building, fire, safety, zoning and ADA codes. It is also good to have the Landlord guaranty the condition of the electrical, plumbing, heating and airconditioning systems for the first 60 to 90 days (if not the entire term of the lease).*



6th Most Common Mistake USING THE LANDLORD’S PROFESSIONALS

Tenants should use architects, general contractors and legal counsel under their control to create and review the various space plans, specifications, costs and documents. Otherwise, Tenant may receive inferior designs and/or fixtures that are less efficient and may dramatically increase yearly operating costs.

7th Most Common Mistake MISUNDERSTANDING THE TRUE SPACE COSTS

Business owners who are inexperienced with commercial real estate are often unable to perform true “apples to apples” analysis when comparing different facility choices. It can be complicated, even for the pro, to compare the different lease types such as: Full Service, Gross, Semi-Gross, Net, Triple Net, etc. Additionally, each Landlords interior finish levels, Tenant Improvement (TI) contributions, lease incentives and a myriad of other factors need to be part of the comparison equation. This confusion leads many owners to make less than optimum decisions.





8th Most Common Mistake: PAYING TOO MUCH RENT

Companies which do not obtain accurate, current market research may pay too high a rental rate. Landlord “flexibility” changes constantly depending upon many factors including current occupancy rates in both their building and the competition, lease length, tenant’s use, parking requirements, financial strength of tenant, etc.

Negotiations are especially important with lease renewals, since Landlords are most competitive when the space is placed on the open market.

9th Most Common Mistake: NOT ENOUGH LANDLORD INCENTIVES

Due to a lack of experience, Tenant did not obtain as many incentives as they might have been able to negotiate. Typical incentives include periods of free rent both before and after lease commencement, discounted rent for various time periods, Landlord contributions to tenant’s build-out costs, landlord improvements to the space, limits on future rent increases, etc.

10th Most Common Mistake NO OUTSIDE INCENTIVES

When a company relocates it may be possible to obtain substantial economic incentives from local government. These incentives include tax rebates, relocation assistance, payroll subsidies during employee training, infrastructure improvements and others.

Many times the statutory incentives can be negotiated up very substantially, and an inexperienced company may leave millions of dollars on the table.

Suggestion: Use an experienced “location analyst & incentive negotiator” to make sure you obtain the best incentives possible.



OTHER COMMON LEASE NEGOTIATION & SITE SELECTION MISTAKES



TENANT PERFORMS THE BUILD-OUT

It may be better to have the Landlord perform actual build-out work, so that unexpected problems or delays will be the Landlord's cost. When it is appropriate for the Tenant to perform the build-out, have the lease provide for an extension if delays are encountered which are not the fault of the Tenant, and extra Landlord monetary contribution if unexpected repairs are required (termites, code violations, etc.).

NO LIMIT ON PERSONAL GUARANTY

Many times it is possible for the Personal Guaranty to expire "x" months after lease commencement, or provide a specific dollar amount of guaranty. Although not as beneficial, it may be possible to use an "Evergreen Guaranty" which provides that Tenant will personally guaranty a set number of months or years, commencing upon default by Tenant. Your professional will know what is typical for your market.

LIMIT ON FUTURE FLEXIBILITY / COMPANY GROWTH

How fast is the company going to grow? Will it be necessary to downsize? How likely is a new partner or merger? These situations, and more, indicate the Tenant's need for as much flexibility as possible. Tenants should work with experienced professionals to insert language into the lease which will allow a cancellation or modification of the lease under certain circumstances.

LIMIT ON FUTURE FLEXIBILITY / PRODUCT GROWTH

Will the company want to carry a new product line or install a new technology? Will a neighboring Tenant vacate (or move -in) which impacts the business? Tenants should be cautious with their "Use Clause" since these clauses can be very specific as to what goods and services the Tenant will provide, and may prevent a Tenant from offering a very lucrative product or service in the future which has not yet been invented!

CHOOSING THE WRONG LOCATION / TURNING MARKET

Tenants who do not know the local market may locate into a declining area, making it impossible to hire and retain the highest quality employees.

CHOOSING THE WRONG LOCATION / PENNY WISE AND POUND FOOLISH

Retail tenants who choose locations in unanchored properties to obtain lower rental rates. Traffic and subsequent sales volumes are dismal, and tenants fight a losing battle.

HAMSTRUNG BY YESTERDAY'S TECHNOLOGY

The office building is not set up with the newest in telecommunications and data cabling, such that Tenant cannot benefit from today's technology. Business is lost to competitors which can offer better service to clients.



TAKE TOO MUCH SPACE

Tenant did not use their own space planner and leased offices which were too large or had an inefficient floor plan.

SPACE WAS MEASURED INCORRECTLY

Tenant did not verify the Landlord's dimensions and figures and paid rent on "phantom" space.

UNNECESSARY SECURITY DEPOSIT

Landlord asks for Security Deposit as standard procedure, but does not require one depending upon Tenant creditworthiness and/or build-out requirements.

NARROW SEARCH

Tenant limits its geographic area of interest too severely, and does not complete adequate market education resulting in lost opportunities.

HOLD-OVER PENALTY IS TOO HIGH

Standard hold-over penalties in first draft lease agreements are typically far higher than necessary.

NOT REVIEWING THE LEASE OFTEN ENOUGH

Tenants miss notification dates, resulting in automatic renewals, loss of option period, or other penalties.

POOR DESIGN

Tenant made poor choices during interior design stage because of focus on "least initial cost" instead of "lifetime operating costs". Many times upgraded lighting, windows, insulation, etc. can make very dramatic improvements in employee productivity, operating costs, and business security. Your professional should be able to discuss the latest in facility design, materials and technology.

POOR PLANNING

Natural catastrophe occurs and electric power is lost for an extended period of time. Tenant is out of business, and losing clients at a rapid rate. Proper planning and/or design can eliminate potential business disasters.



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