

## **“Renewing Your Lease: Don't Let Your Company Become a Captive Market”**

**By Michael Coretz**

Many tenants assume their lease will be renewed on reasonable terms and accordingly leave a perfunctory amount of time for the renewal to be handled. Then it turns out that the landlord's draft proposal involves substantially higher costs than anticipated. Because there isn't enough time to determine if a better alternative can be negotiated elsewhere, such tenants are stuck. That's why a lot of tenants, including Fortune 500 companies and national law firms, often end up swallowing a bad deal.

At the very least, you can bet that as a renewing tenant, your landlord will offer terms inferior to what is being offered to new tenants. After all, new tenants are in the market shopping around. To attract new tenants, the landlord must be willing to match the competition in terms of rent, free rent, utilities, workletter, building systems, communications capability, security systems, electrical capacity, lobby appearance and other factors. But if you are a tenant interested in a renewal, the landlord presumes – and tends to be right – that you're not shopping around much. The landlord figures you're mainly concerned to avoid the cost and disruption of a move, and he can probably keep you in the building without offering you nearly as much as he offers a new tenant.

If you assume the cost and disruption of moving are so high that your only good option is to renew your lease, it will become your only option.

You will be a captive market, and you could easily miss substantial benefits your landlord offers as inducements for new tenants.

Here's a proven strategy for maximizing the value of any renewal – even if you are 100% committed to staying at your current location.

*1st: Use time to your advantage*

You need to start early enough so you have time for all the normal phases of site selection, financial negotiation and analysis, lease negotiation – plus time to walk away from a bad deal and continue negotiations elsewhere if need be. This means if you plan to renew at your current location, for a lease in the 50,000 sq. ft. range, you should be actively assessing your options at least 18 months before your target move-in/renewal date.

*2nd: Understand your options in the marketplace*

If you don't have a good idea what lease terms other tenants in the marketplace are getting currently, then you have no way of determining whether a landlord's proposed renewal is a good deal or a bad deal. Your landlord's offer could easily be inferior to what tenants in your area and across the country are getting, in which case it would qualify as a bad deal even though it might be an improvement over your original lease.

Rent and workletter allowance are just the beginning. Every bit as important are terms buried in the fine print, terms which can undermine what you assumed to be a good deal. For instance, the operating expense clause, electricity clause, use clause, and sublease clause all may impose significant effects on your finances and

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flexibility.

*3rd: Use your inside knowledge of your current building and landlord's operations*

As a long-time resident of the building where you plan to renew, you have a key advantage that can help you secure improved lease terms. You know the physical characteristics of the building and how it has functioned in the past. If you have always been dissatisfied with the way the common area lavatories look, elevator wait times, how the HVAC system functions, etc., you should be specific about these issues in negotiating your lease renewal. Seek specific quantifiable improvements. Calculate a reasonable dollar value for each improvement to be made and stipulate a penalty or consequence if changes agreed upon are not made within an agreed-upon time period.

*4<sup>th</sup>: Analyze your current lease for business and operational terms that have been inadequate, too costly, or resulted differently than you expected*

If, during your years in this building, you have had a real estate advisor who regularly performed detailed annual escalation audits, you have additional inside information that can be extremely valuable to you in structuring a lease renewal. Done properly, these annual audits show you how efficiently your landlord runs the building and what the mark-ups are for certain kinds of important as well as incidental services. Moreover, these audits will show you whether your landlord bills twice for the same services, whether you are paying for services supplied for free to other tenants, whether your landlord uses insurance reimbursements as a cost center, and how your costs compare to the market. Use this information in improving critical business and

operational terms for an extended lease term. In the hands of an effective tenant representative, the data generated by these audits gives you a second chance to secure the lease terms you really wanted the first time around.

*5th: Let your landlord know you are actively seeking alternative solutions for your space needs*

Preserving good relations with a current landlord is often cited by tenants as a reason for "going it alone" when it comes to handling a lease renewal. The unfortunate effect of such a strategy is that it reinforces ownership's belief that you have no options and don't take the prospect of lease negotiations seriously. It's a clear sign that you are prepared to settle for whatever is offered.

Handling a lease renewal should be treated like any other business operation

– the management team makes a reasoned assessment of all relevant options and selects the best fit. It's important to let the building owner know that this is your approach to whatever terms they might offer – or expect you to accept in a lease renewal.

When a landlord understands that you are having a tenant representative objectively evaluate the marketplace, they are likely to become more realistic about what renewing your lease is worth to them. Making sure the owners know you are serious about your options can help you secure concessions very similar to those being offered to new tenants, and a more favorable rent structure. A representative familiar with the market

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can be of invaluable assistance.

*6th: Understand what it will cost your landlord if you move out*

A common stumbling block in renewal negotiations is the undeniable fact that no matter how good a deal you will get by moving, you will also incur costs that may be substantial – the cost of the physical move, new telecommunications wiring, perhaps costs of building out a new space that goes beyond what the owners will supply, new stationery, perhaps new furniture, etc.

Yet the landlord, too, will incur substantial costs if you leave for more favorable terms elsewhere. For instance, potentially lost revenue, promotional costs, brokerage commissions, infrastructure refurbishment, demolition costs and build-out costs. In every situation, these costs can be quantified with a high degree of accuracy, and should be part of discussions with landlord to maximize the value you get as a renewing tenant.

The differential in these costs – what a landlord will spend to attract a new tenant, and what they will spend to retain you – can be substantial, and easily exceed a year's rent. With an astute tenant representative and a properly structured negotiation – some portion at least, of these savings, can be used to further reduce your costs should you elect to renew at a current location.

*7th: Be prepared to move if you can't get market-rate terms*

Ultimately, if your analysis of the market, taking into account all relevant factors shows that a substantially lower present value occupancy cost will result from moving, this is probably the option you should select. Moving for marginal savings – 2% or 3% – might not be warranted, but if projected savings are 5% or more, this is likely to be your better option. No matter how specialized your facility, no matter how convenient its location, no matter what the cost of build-out, if a comprehensive site selection process, financial and lease analysis shows you can get better terms elsewhere, it may be time to move on. Occupancy costs are often the second largest fixed cost a tenant faces; in total they may consume up to 50% of net revenue. Managing occupancy costs is a critical corporate responsibility. When landlords understand that lease renewals are not a "sure thing"; when tenants regularly subject lease renewals to an objective, market-driven process, the result is likely to be reduce occupancy costs across the board.

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