

Top 10 lease negotiation and facility selection mistakes

May 06, 2009 - Front Section

Mistakes? Everyone makes them. Here is my personal list of the ten biggest mistakes tenants make when it comes to lease negotiations and facility selection ... and how to avoid them.

1. Starting the Process Too Late - Most companies fail to realize how long it takes to perform a well-executed commercial real estate transaction. The search for commercial space is not like searching for an apartment. By starting the process early, tenants gain control of the process, increase their number of options, and enhance their leverage. Identifying a firm's real estate needs, looking at properties, and conducting a comparison analysis can take as little as a week for motivated companies already familiar with the local market. Unfortunately, this is just the beginning of a process that can take several months. Negotiations with several landlords to obtain the best transaction can take weeks, even months. Once the parties have agreed to lease terms, lease preparation, negotiations, and execution can easily take weeks or months. Once the lease is signed, some degree of tenant finish work is usually required. Unless it just cosmetic changes (carpet, paint, etc.), expect several weeks to prepare construction documents, a week or so to competitively bid the work, a few weeks or a few months to obtain a building permit depending on the municipality, and one to two months for actual construction. Therefore, savvy tenants generally start their search for space at least six months prior to the time they expect to move and more if a large/complex transaction or build-to-suit is a possibility.

2. Failure to Use a Qualified Real Estate Broker - The vast majority of companies use commercial real estate brokers to assist them in developing their real estate needs, finding the best properties that fit those needs, and negotiating the transaction. Those firms that attempt to solve their real estate problems by themselves are committing a costly mistake. Driving around looking for signs on buildings to call is a major waste of time. Businessmen might be involved in handful of real estate transactions over their career. Good real estate brokers complete dozens of transactions every year. To illustrate, ask yourself this question: would you try to take out your own appendix or represent yourself in a court of law for a serious crime? No. You would hire an expert to assist you. Real estate is no different.

3. Selecting a Tenant Representative Broker Based on the Reputation/Resume of the Firm - The firm may be a national entity that collectively has an impressive resume. Beware, not all brokers in that firm may be the best broker for your needs. The broker could be too new to the business, might not understand the market you want to be in, might not be a specialist in the type of real estate your firm needs (office, industrial, retail, etc.), or might take the approach that a broker's job is limited to helping his clients find suitable space. The right broker knows that finding the space is only the beginning and is the easiest and least time consuming part of the process. The right broker has the qualifications and the drive to do so much more. Hire the broker, not the firm.

4. Inadequately Forecasting Future Needs - Companies that focus solely on their immediate real

estate needs may be faced with the costly and time consuming act of re-addressing their real estate needs sooner than anticipated. In addition to defining current needs relative to square footage requirements (number and size of rooms), type of floor plan (open, hard walled offices, or a mixture), parking needs, communications needs, access, etc., tenants should also consider their long-term needs. By obtaining facilities and lease terms that allow a company to expand, downsize, or relocate as circumstances dictate, companies can avoid the brain damage, expense, and loss of productivity associated with relocating too soon after their lease has commenced.

5. Misunderstanding the True Cost of Space - Business owners who are inexperienced in commercial real estate are often unable to adequately perform an "apples to apples" comparison of several real estate choices. This can be a complex drill even for a real estate professional. Leases and the underlying economics can come in many varieties such as: full service gross, expense stop versus base year, modified gross, triple net, etc. Additionally, each landlord's existing interior finish levels, tenant finish contributions, lease incentives (free rent, moving costs, etc.) must be factored in to determine the optimum financial package.

6. Failure to Leverage Properties Against Each Other - Often times tenants zero in on their favorite building and attempt to negotiate a suitable transaction with just that building. By selecting several buildings that best fit their needs and negotiating simultaneously with the top choices, tenants achieve more leverage and force building owners to compete for their business. The result is a more favorable transaction for the tenant, even if it is still their "favorite building."

7. Underestimating the Condition of the Premises - Tenant's that take a property on an "as-is" basis are taking a great risk. Even if the space looks good, building codes may have changed or the property's infrastructure may be inadequate. It is best to have the landlord warrant that the property meets current building, zoning, fire, life safety and ADA codes. It also makes sense for the landlord to warranty that all electrical, plumbing, and HVAC are in good working order and anything that malfunctions during the first three to six months shall be repaired/replaced by the landlord at landlord's cost.

8. Lease Commencement is Not Tied to Completion of Construction - This has been a disaster for tenants who did not properly estimate the time needed to complete construction documents, competitively bid work, pull the necessary permits, and complete construction. This can eat up any free rent periods tenants have and cause budgetary nightmares. When possible tenants should allow the landlord and their experts to complete the tenant finish work as that is their core business. Further, the lease commencement must be tied to completion of tenant finish work unless the delay was the direct result of the actions of the tenant.

9. Providing Too Much Security - Your firm does not have a strong balance sheet so the landlord wants a personal guaranty and a bigger security deposit. You hear that all the time, right? There are many alternatives to solve this problem that an experienced real estate broker can lead you through. For example, why not negotiate that the guaranty be limited in some fashion and that a portion of the security deposit be refunded over time if your firm lives up to its leasehold obligations?

10. Not Reviewing the Lease Often Enough - Tenant's often miss opportunities by not being familiar enough with their lease and the rights and obligations it provides. These rights and obligations could include the right to expand, contract, terminate, renew, obtain a refund on a portion of the security deposit, etc. Therefore, your real estate broker should provide you a concise but detailed lease summary that outlines these issues and he should periodically provide reminders of these critical dates/events.

Now that we have identified the mistakes, let's do our best to avoid making them.

Stephen Epling is principal of Triumph Real Estate Corp., Engelwood, CO.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540