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Inside Commercial Real Estate

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Lease Negotiations With A Corporate Team

A few years ago, senior corporate managers were able to make major real estate decisions by themselves. Now, a negotiating team will negotiate leases. This team may consist of legal counsel, finance department representatives, outside specialists such as real estate brokers or tenant representatives, design and engineering consultants, and others.

In today's market, corporate tenants with high credit ratings, who are willing to make long-term lease commitments negotiate from a strong position. Therefore, corporations that formerly treated real estate transactions in a casual way have now developed detailed real estate negotiating strategies. The corporate tenant sees these negotiations as a way to cut costs within the company (whether upsizing or downsizing).

Landlords, developers, and brokers must be aware of this new style of negotiation. While the real estate executive plays a key role in developing the strategy, the other parties must be ready to respond quickly to requests for information and be prepared to discuss issues that rarely if ever arose in the past.

Request For Proposal

The document that best illustrates the new negotiating process is the Request For Proposal (RFP), sent to property owners. The RFP incorporates the specification for rental rates, free rent, up fitting, operating expenses, options, cash incentives and other "money clauses" that the corporation intends to negotiate. A short list of prospective sites or buildings is then prepared based on the initial responses to the RFP. The corporate real estate executive (often with the aid of a real estate broker) will negotiate to obtain the best deal with the prospective landlords.

The RFP usually contains a number of items that are non-negotiable, for example, amount of usable square feet, geographic area, lease term, expansion option, parking facilities, and security. On the other hand, many items remain negotiable, such as rent rate, concessions, rent escalations, cash inducements, and amenities. The parties should understand from the outset that failure to obtain a non-negotiable term could kill the deal for the tenant. Other items may be "throwaways" that could be modified or omitted from the lease.

Example: A corporate tenant may lack the capital funds to improve the leased premises, (continued

and so may be willing to pay a higher rental rate or extend the lease term in exchange for a larger allowance for improvements. Alternatively, the tenant may be willing to fund all or part of the improvement costs in exchange for a lower rental.

Give-and-Take in Negotiations

Although it is obvious that any negotiating process involves give and take by both sides, corporate real estate executives have learned the importance of understanding the strengths and weaknesses of their bargaining position as well as that of the landlord. Within reason, these tenants are assured of getting whatever is needed if the bargaining team is aware of the options and takes carefully calculated risks based on solid information. ❑

Choosing The Right Investment Property

No single property can fit all of the investment goals and rules an investor has set. Even if the investor tried to build a property to specifications, he would find some things “not quite right”. The investor is, therefore, wise to anticipate problems and have some basic strategies for dealing with them. Here are some suggestions to help the investor devise other approaches to meet special needs:

- Energy saving potential is more important than style or appearance. Given increasing shortages of natural gas and rising prices of fuel, energy saving has become paramount for successful real estate investing.
- Location is usually more important than the buildings on the lot. You can always make repairs and improvements to a building, but you can’t do anything to change the qualities of a location.
- An older property is preferable to a new property if you want to be reasonably certain about income and cost potentials and are seeking the most rentable space for each investment dollar.
- Good workmanship is preferable to good materials if you have to make a choice. Workmanship can overcome the defects of poor materials, but you would pay constantly for poor workmanship. Hopefully, you can avoid this kind of choice because poor workmanship and poor materials mean extra costs and continuing problems.
- Low down payments are preferable because they increase the earning rates on your equity. However, be sure you have a financial reserve in case the property does not produce enough net income at times to pay for the financing.
- Plain properties without distinctive architecture or other characteristics are the most durable investments. Luxuries or extras may make the property look better, but they do not improve the income potential.
- In a given market, smaller units will usually be more saleable, easier to manage, and easier to keep rented in changing markets. Any apartment property with more than 20 units will require professional management.
- Size of the property and units within the property should fit the average for the market. Smaller or larger units often present problems that result in lower prices and higher costs.
- Use experts when in doubt. The costs of using appraisers, builders, lenders, and lawyers are considerably less than those associated with making mistakes. If your investment cannot produce enough income to let you pay for expert help, then it may be the wrong investment.
- Convertibility. The property should lend itself to changes as the market changes so that you can always maximize the rent potential.
- Flexibility. The space in the property should be easily changed to meet different user needs at minimal costs of time and money.
- Specifying repairs to be made before buying is a safer, less costly financial strategy. Estimate them ahead of time, thereby being able to negotiate for a lower price.
- Financing trade-offs. To keep loan payments low, negotiate for long-term payout bases at equivalent rates. Include in your estimates the initial costs of the loan and the repayment costs and privileges. ❑

Drafting The Shopping Center Lease

When leases for shopping centers are being drafted, they can be more difficult than most other commercial leases. In a shopping center, the owner wants the leases to be as uniform as possible, but knows that each lease must have variations to meet the individual tenant's particular problems in business and in certain size or shaped spaces.

Here are some suggestions of items that should be covered in your shopping center leases. There could be many more depending on each property.

- **Type of Operation;** What is the business? The lease must clearly state the type of business conducted in this unit.
- **Effective Date of Rent;** The minimum guaranteed rent should commence a specified number of days after the center has completed the premises or when goods or services are offered for sale to the public, whichever of these two events occurs first.
- **Amount of Minimum Rent;** The lease states the monthly and annual rent. It should also provide that if the gross leasable area is larger than that recited in the lease, the minimum monthly rent will increase by a specified amount each month.
- **Costs of Common Areas;** The tenant should be required to pay its proportionate share of the costs of operating the center's common areas, including the following:
    - Repairs
    - Light Bulb replacement
    - Landscaping
    - Security
    - Cleanup and Snow removal
    - Parking lot sweeping
    - Restriping parking spaces
    - Garbage removal
    - Real estate taxes
    - Liability and property damage insurance
    - Depreciation on equipment and machinery

  and any other costs of operating, and maintaining common areas.
- **Noncompetition Clause;** In order to ensure noncompetition with your center, you should include a provision that prohibits the tenant from directly or indirectly engaging in a similar or competing business within a specified radius (expressed in miles) of your center.
- **Computation of Percentage Rent;** The lease should show how percentage rent is computed, when payments will be due, and what will be included in gross sales for determining the percentage rental (e.g., vending machines and mail order sales). This clause should also specify how frequently the tenant will be required to submit sales reports to the landlord and that the tenant's annual sales report must be prepared by a certified public accountant.
- **Employee Parking;** As the landlord, you should reserve the right to control employee parking. You should also provide that you have the right to remove any unauthorized people from the parking areas, as well as from any common areas.
- **Center's Merchant's Association;** The lease should provide that the tenant must be a member of the center's Merchant's Association.
- **Signs;** As the landlord, you have the right to approve the size, placement, and contents of any and all signs within the center. Such a provision may prohibit paper signs, exposed neon signs, sandwich boards, etc.
- **Property Tax Increases;** The owner may specify that he will pay the real estate taxes on the leased premises and the underlying land for the first year after the center is open, but that any increases after that will be prorated and passed along to the tenants.
- **Recapture Clause;** Landlords should include recapture clauses in their leases so that they can cancel tenant's leases if rental deficiencies are not paid.
- **Permission for Assignment and Sublet;** In order to somewhat control the situation, you should have the lease provide that a tenant may not sublet or assign its lease unless it first gets your written consent to do so, and the clause should state that a consent to a particular assignment or subletting will not apply to later assignments or sublettings.
- **Insurance;** The tenant should be obligated to have property loss and personal injury insurance, naming the landlord as an insured. The tenant should be required to insure any boiler on its premises. The tenant should also be required to have fire and extended coverage insurance on its merchandise and fixtures. ❑

Who Buys Commercial Property

When we represent a seller of a commercial property, we try to determine, as soon as possible in the marketing process, what type of buyer is most likely to be interested in this particular property. We then focus the main appeal on those elements that are most important to that type of buyer.

Types of Buyers

Normally there are three types of buyers for commercial property:

- **Investors,** who seek an income-producing investment in which to place their surplus funds.
- **Speculators,** who buy so they can sell when the market goes up.
- **Users,** who seek sites for their businesses.

The seller's agent will appeal to the special interests of each of the three types of buyers. Advertising and marketing materials should develop each appeal and furnish supporting facts, realistic projections, and professional information.

The Appeals

For the primarily income-seeking buyers, we focus on the financial data, concentrating on rentals from the property, terms of the leases, maintenance charges, mortgage information, and net income. We will also demonstrate the probability of income growth from the property.

For the speculator-buyer, the stress is on the potential for a resale profit. We might show that the property is in the line of future development (new public transportation is planned or being built, or there are other newly built or renovated commercial properties as neighbors). Demonstrate that the property is in a growing, vital locale.

Since income is of only a secondary interest to the speculator-buyer, we'll go no further than the current income status. The focus will be on the potential for profitable resale.

The location will be of greatest interest to the user-buyer. Is it right for the user's business? Is the building in good physical condition, or must it first be remodeled, improved, or up-dated? We must demonstrate the wealth and habits of the surrounding population.

With each type of potential buyer, the marketing effort will focus where it is most likely to produce a prompt, successful sale. ❑

Your Real Estate Investment

Knowing what you can do in some investment situations can be the difference between an annual profit or loss in your currently owned commercial property or the one you intend to acquire. How you acquire it can be important.

The professional commercial real estate broker is in the position to represent a client in real estate transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of real estate. This real estate practitioner stays aware of current tax laws and court decisions in order to structure transactions, but does not give legal or tax advice (unless he/she is also an attorney or a certified public accountant). In any complex transaction that might result in changes in any owner's legal or tax situation, the other members of the "consulting team" should be the owner's attorney and/or tax advisor. We always recommend consulting with these professionals during the planning and closing of major real estate transactions. All can affect taxes and estate planning.

We are the heart of your professional team, creating the real estate transactions that will be needed to expand your estate. Let's get together to evaluate your present portfolio of properties, or review your plans for future acquisition.

Starting with your present position and your goals for the future, we can set out moving directly toward achieving those goals. ❑

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