

TOP 10 LEASE NEGOTIATION & SITE SELECTION MISTAKES



A Survey of the
INTERNATIONAL TENANT REPRESENTATIVE ALLIANCE

compiled by
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"The Ph.D. of Commercial Real Estate"



Certified Commercial Investment Member

TOP 10 LEASE NEGOTIATION & SITE SELECTION MISTAKES

Executive Summary

The following list of Top 10 Mistakes is the result of a survey taken in the first quarter, 1999, among members of the prestigious International Tenant Representative Alliance. Member respondents 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.

**#1
Most
Common
Mistake**

WAITING TOO LONG TO START THE EVALUATION PROCESS

Market research, facility inspections and analysis can usually be completed in a week or so by highly motivated companies which are already familiar with the local market. However, even after a location has been targeted, negotiations with the Landlord and legal preparation of the documents can take weeks, even months depending on the Landlord, attorneys and corporate bureaucracy (Landlord's and Tenant's).

After the Lease is finally signed (and assuming the space is not going to be taken as-is) architectural plans need to be completed (1 -2 months), building permits need to be obtained (1 - 2 months, depending on local government policies and requirements) and then the actual build-out can get started (1 - 2 months, average).

If existing facilities cannot be found which are acceptable, then a ground-up Build-to-Suit needs to be performed, which 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.*

**2nd
Most
Common
Mistake**

BEGINNING A SPACE SEARCH WITHOUT DETERMINING BOTH CURRENT NEEDS & LONG TERM PRIORITIES

Current needs include evaluating square footage requirements (how many rooms and what size), type of floor plan (open, private, or a mixture), communications needs, parking needs, access and security needs, etc.

Long term planning includes obtaining facilities and lease terms which allow companies to expand, downsize or relocate as circumstances dictate. (See "Future Flexibility" below)

Suggestion: Start the market research and facility search after meeting with leasing experts and space planners/architects and after decisions have been made regarding office layouts, modular furniture, hoteling, size and amenity requirements, etc.

**3rd
Most
Common
Mistake**

HIRING THE WRONG BROKER OR USING NO BROKER AT ALL

Unless someone in the company is already an expert in commercial real estate, most business owners cannot (and should not) take the time to learn this new industry.

A good Tenant Rep counterbalances the Landlord's team of professionals, and is an important source of market knowledge and negotiation expertise. The *wrong* broker may provide incomplete information, or have conflicting loyalties because of hidden agendas or Landlord relationships.

Since commissions are paid by Landlords on most transactions whether or not the Tenant is represented, the additional cost for Tenant Representation is usually zero.

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

**4th
Most**

LEASE COMMENCEMENT DATE IS NOT TIED TO BUILDING COMPLETION

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Common Mistake

Unexpected delays in the planning, permitting and construction stages can eat into a Tenant's rent-free build-out period and cause unexpected budget problems. 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

CONDITION OF 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. 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 air-conditioning 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

LACK OF UNDERSTANDING THE TRUE SPACE COSTS

Inexperienced Tenants may be unable to perform true "apples to apples" comparisons when determining different Landlords finish levels Vs. Tenant Improvement (TI) contributions and lease incentives.

In addition, Tenants may not understand the different lease types such as: Full Service, Gross, Net, Triple Net, etc., This confusion may cause business 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 LEASE INCENTIVES

Due to a lack of experience, Tenant did not obtain as much discounted rent or Landlord contributions to their build-out costs as they might have been able to.

10th Most Common Mistake

NO OUTSIDE ECONOMIC 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.

OTHER COMMON

TOP 10 LEASE NEGOTIATION & SITE SELECTION MISTAKES

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. Following are four examples:

- 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 a 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 a Tenant flexibility in that if it must relocate, it may sublease the space and mitigate the economic pressure.

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.

TOP 10 LEASE NEGOTIATION & SITE SELECTION MISTAKES

PAY A SECURITY DEPOSIT WHEN IT WAS UNNECESSARY

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

TOO NARROW OF A 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.