Save by leasing space

Being mindful of the details in commercial leases can be profitable.

Interviewed by Leslie Stevens-Huffman

Most CEOs review commercial lease agreements with an eye on the legal language and the rental rate, but taking a deeper dive into the agreement's terms and conditions can have its financial rewards.

"There are issues in commercial leases that CEOs and CFOs may not be aware of, and consequently, they get overlooked during the commercial lease negotiation process," says Ronald A. Schagrin, SIOR, senior director of Prudential CRES Commercial Real Estate South Florida. "Knowing how to dissect the terms and asking for the appropriate detail behind many of the charges included in commercial lease agreements can save you money. In addition, it's important to anticipate a number of potential business scenarios that might come up in the future and secure terms that will be favorable to your bottom line under a variety of business conditions."

Smart Business spoke with Schagrin about the ways that CEOs can save money when negotiating commercial leases.

Ronald A. Schagrin, SIOR
Principal
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What are some of the costs that might be hidden in the landlord's operating expenses?

It's common for tenants to be charged a pro-rata share of the landlord's operating expenses, but what constitutes those expenses? Tenants should ask for a detailed copy of the landlord's operating expenses, review those costs and ask that charges unrelated to building operations be removed. For example, the landlord's operating expense statement might include legal costs that have been incurred during dispute resolutions with other tenants. You shouldn't have to pay a pro-rata share of those types of legal charges.

Also, there should be a statute of limitations on when you can be assessed operating expense pass-through charges. It's reasonable for the landlord to take six months to review his or her charges, reconcile his or her operating expenses and issue his or her assessments. To eliminate surprises, don't leave the review period open-ended.

What terms and conditions might come into play if my business expands or contracts?

Be mindful of your ability to assign your leasing rights or to sublease your space. If your business either expands or contracts, you may need to adjust your space requirement or your location. Your landlord should not be able to unreasonably withhold your ability to sublease.

Another provision that may come into play under changing business conditions is your ability to terminate your lease. Let's say, for example, that you are five years into a 10-year lease term, and your business is growing, necessitating a move. You want to have the right to terminate your lease without paying a penalty. In that case, the only charges you should pay would be the unamortized costs of the leasehold improvements and commissions.

Which lease terms affect day-to-day business operating costs?

Two things in commercial lease agreements that can impact a company's ongoing cost of operation are the cure-and-deduct clause and the square footage used in determining your rent. Always verify the square footage of the space you are leasing. Associations like the Building Owners and Managers Association (BOMA) or architects can validate your rental square footage. Also, in the event that your landlord doesn't repair a problem in your space within a reasonable period of time, like fixing a leaky air conditioner, you want the ability to repair the problem yourself and deduct the charges. Paying for square footage you don't have over the course of a long-term lease or putting up with business interruption from untimely maintenance can cost you money.

Given today's business climate, you want to make sure that you have a nondisturbance clause in your lease. If your landlord can't meet his financial obligations and the bank forecloses, you don't want to be forced to move incurring unplanned costs.

What other cost-savings recommendations do you have for CEOs?

1) Consult with a real estate attorney when negotiating leases.

Every state has nuances to its lease agreements, and CFOs may not be trained to spot the pitfalls and the opportunities to save money. You will definitely achieve return on investment from having a lawyer review your lease agreement.

2) Work with an experienced real estate agent. The landlord pays the cost of tenant representation, and tenants can benefit because the real estate professional will know the current market conditions and they will negotiate on your behalf.

3) Keep a signed copy of your lease agreement on hand and diary the critical time lines and key dates. Renewal dates and options contained within leases can pass by unnoticed, unless you keep track of them.

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