

**ATTENTION COMMERCIAL TENANTS
LEVERAGE IS THE KEY TO A BETTER LEASE DEAL**



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In my ten years of commercial real estate practice, I have never seen a better opportunity for tenants to reduce costs or secure better space. With few exceptions, today's commercial leasing market is a tenant's market. Tenants should not shy away from renegotiating their leases early to take advantage of the favorable market conditions.

It's All About Leverage

I have been saying the same thing to my clients for many years, which is that lease negotiations are largely about leverage. In a landlord's market, the only leverage a tenant has is to begin negotiations early and keep all options open, including moving to new space. For example, if a tenant has been leasing 20,000 square feet of office space for the past fifteen years it is unlikely that the tenant wants to move. Landlord's know this. Therefore, the landlord will wait until as late as possible to approach the tenant about renewing its lease. Waiting serves the landlord's interests, because at some point there is not enough time for a tenant to find new space, negotiate business terms, engage legal counsel to document the deal, complete improvements to the new space, pack up their existing space, retain a moving company, and move into the new space. Depending upon the size, type, and complexity of the space, negotiations should begin anywhere from two years to a few months in advance of commencement. Many small commercial tenants believe that they can pack and move into a new space that does not require improvements quite quickly, however, they frequently forget that at least a few months must be allotted to finding the new space, negotiating the business terms, completing legal documentation, and moving.

Leverage shifts to the landlord in negotiations when the landlord knows the tenant does not have sufficient time to move before the expiration date of the tenant's current lease. Unless there is a provision in the tenant's current lease to the contrary, the tenant will likely become a holdover tenant on the first day after the expiration of the term. In the best case scenario, the landlord will have to provide a thirty day notice to quit which would not be effective until the last day of the calendar month following the thirty day notice. Accordingly, in the best case scenario, a tenant would have sixty days to vacate if landlord delivered such a notice on the first day after the expiration of the term. That may be helpful, but it is not something to rely upon for two reasons.

First, this is not the rule in all places. In some jurisdictions required notices will be effective 30 days after delivery even if that is not the end of a calendar month. Likewise, in some jurisdictions a tenant may be hauled into court in less than thirty days. Second, the tenant

may be held liable for damages suffered by the landlord as a result of tenant's failure to timely vacate the premises. Consequential damages of this type can add up quickly. Accordingly, tenant's are advised to plan well in advance to avoid a situation where the landlord gains leverage because the tenant cannot vacate the premises in a timely fashion.

Conversely, early planning and action shift negotiating leverage to the tenant and save tenant money in the long run. For example, if tenant's lease is set to expire on December 31, 2010 then tenant should begin (or already be in) the process of renewal or new lease negotiation now. The tenant should begin by sending out a request for proposal to its current landlord and to at least three other landlord's with suitable space available. The proposals received will form the basis of tenant's decision to move or stay and will help shift leverage to tenant in its negotiations. Tenant should make it known to its current landlord and others receiving the request for proposal that all options are being considered. To keep confidential the fact that tenant is exploring all options is to negate the leverage obtained by starting early and exploring options.

How to examine a proposal and what information to request be included in a proposal is the topic of another article, but suffice it to say for purposes of this article that the tenant should negotiate each possibility seriously to obtain the best possible business terms. Such terms are not simply about rent, although that is the single largest business term, but also about obtaining other tenant friendly provisions or rights. A tenant's current lease may not permit assignment or subletting without landlord's consent, which consent may be withheld by landlord for any reason or no reason at all. Such a provision is not tenant friendly or reasonable, in my opinion. The tenant should state in its request for proposal that the right to assign and sublease with landlord's consent, which shall not be unreasonably withheld, delayed, or conditioned, is an important business term to tenant (there are many variations of this provision that may be important for one reason or another to the tenant, but for example purposes, I have kept this simple). Any proposals received that include this provision can then be used to negotiate such a change in the tenant's current lease if the current landlord submits a competitive proposal.

Multi-Track

In my experience, the average new lease acquisition unfolds something like this: A prospective commercial tenant will look at various spaces and make a decision about which space best suits their needs and desires. Based upon that determination, the tenant makes the decision to lease that space and requests landlord's form lease. There may be some negotiation over the base rent, but not much more than that. The tenant then goes back to her office and waits for the landlord's draft lease. Several weeks may go by before the initial draft is received. During the wait period, the tenant is comfortable that she has found the space she wants and all other leasing activities have ceased. Either through communications between tenant and prospective landlord directly or through brokers, the message is communicated that the tenant is excited about the new space and cannot wait to move.

The landlord's draft lease arrives and it is a typical landlord oriented lease. During legal review, many issues arise that tenant's counsel advises against, but tenant reminds its counsel that this is the space tenant wants and there are no other options being considered. In addition, it is most likely too late to consider other space because now there are only two or four months left

until expiration of the current lease as opposed to the six, nine, or twelve months that were left when tenant first began to search for new space. Tenant's counsel negotiates the best deal possible considering that landlord is not willing to negotiate too much because landlord knows the tenant really loves the space and does not have time to find and negotiate new space before its current lease expires.

The point is that the tenant should always be multi-tracking its negotiation process. The tenant should begin early and always continue negotiations with current landlord and prospective landlords until the tenant's attorney is comfortable that the form of lease is negotiated to a point where the remaining issues are not significant. This way the tenant can say to the landlord "the first one to give me a lease that my attorney says I can sign wins". With that pressure and leverage, the deal will move faster and most landlord's will be more willing to negotiate.

Yes, this multi-track approach will result in higher legal fees and tenant time spent up front, however, it should result in a better rental rate and better lease terms for the tenant, which will more than pay for itself in the long run.

Example

An office tenant's lease was set to expire December 31, 2009. The tenant has a small space of approximately 1,300 square feet, but it is on Madison Avenue in Manhattan, so even that small space equates to a lot of dollars. In December 2008, the landlord approached the tenant about renewing for ten years. The tenant was receptive and asked the landlord for a proposal. The proposal was promptly faxed over to tenant and stated that renewal would be for ten years at \$45 per square foot with a formula for escalations. The tenant was inclined to agree and execute a renewal amendment because, as the tenant put it to me, "the landlord is a good guy and I trust him. He said this is the going rate now". The tenant's wife convinced him to call me just to be sure everything was okay.

The tenant reluctantly called me and faxed me the landlord's proposal and their current lease. I quickly determined that the landlord had other vacant space in the building that was advertised at \$40 per square foot. I brought this to the landlord's attention and he dropped the proposal to \$40. That saved the tenant approximately \$60,000 over the term.

I then suggested to the tenant that they look at other spaces on the market. They did and found two spaces that they loved. They received proposals from both of those landlords one of which was at \$40 per square foot and one of which was at \$38 per square foot. I then reviewed their current lease and made a list of provisions that were deficient or unfair to the tenant. We redacted the proposals from the two vacant spaces so that the landlord and address were not visible and sent them to the current landlord. The tenant told the current landlord that while they would like to renew in place, they were willing to move if they did not get terms they considered favorable. The landlord did not cave right away, but the tenant's determination to move if the current landlord did not improve its proposal led to a ten year renewal at \$37 per square foot, an increased base year for taxes and expenses (left out of landlord's original proposal), release of tenant's personal guaranty, and other changes favorable to tenant. I have no doubt that without the credible threat of moving, the tenant would not have been able to negotiate such a good deal.

In the end, the tenant will save between \$80,000 and \$100,000 over the ten year renewal term and have no personal liability.

Cautions

Shifting leverage by shopping around and knowing the market conditions is one thing, but taking the opportunity to renegotiate other terms of the lease is another. Tenant's must bear in mind that a landlord may perceive renegotiation of lease terms other than base rent and length of renewal term to be a renegotiation of the entire lease. Accordingly, the landlord will feel free to review the lease for provisions that the landlord would like to see amended to suit the landlord. There is not much that can be done about this except to plan carefully with your legal counsel and utilize whatever leverage can be mustered.

To a large extent this is a game of chicken. Most tenants do not want to move and most landlords do not want to lose a tenant. However, there is no greater leverage for a tenant than a credible threat of moving. In some cases, tenants really do find better space and end up moving and that's okay. However, without the credible threat the landlord has no fear of losing the tenant and little or no motivation to negotiate a good deal for the tenant.

There are many good brokers serving the commercial leasing community, however, it has been my experience that tenants should not share their strategy with their real estate broker or anyone outside the immediate circle of decision makers. In far too many instances, brokers and others, whether accidental or otherwise, have told landlords or landlord's broker that the tenant is looking at other space, but they are not serious. Clearly, this negates the entire strategy.

Conclusion

While the principles espoused above work in all market conditions, the current conditions are exceptionally favorable to tenants. Landlords in most markets today are desperate to keep tenants and sign up new tenants. What I suggest in this article is not intuitive to most tenants, but if kept in mind I am reasonably certain that tenants will get a much better lease deal than waiting for the landlord to approach the tenant a couple of months prior to expiration. Knowledge of the market place and time to pursue all options equals leverage for the tenant.