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Negotiating the Perfect Lease: Don't Overpay For Your Retail Space

Now that you have found the perfect space for your business, it's time to move forward and sign the lease.

Many people do not realize that a business lease is negotiable and wind up paying the asking price.

A very common, but costly, response from business owners.

The longer it takes to find that "perfect" location, the more likely you will be to simply sign the lease as presented.

After all, you don't want to let that perfect location get away. While this is perfectly understandable, it is an absolute fallacy.

Trust me. I have been in this situation before and wound up paying way too much for a lease. Ultimately, this was a factor in a failed business I previously owned.

Keep in mind that I am not going to tell you how to find the perfect location for your business (you can check out Greg Brown's article on that subject in Business.com here). There are so many factors involved; price, location, size and covering them all in 2,000 words is unlikely. I want to focus on how to negotiate the best deal once you do find that space.

Sign a Percentage-Based Lease

Landlords know that they cannot get paid if you are not making money. As such, most commercial landlords want to do everything in their power to help you succeed. Not only does it assure rent will be paid, but also helps bring in new tenants as they see other businesses at the location doing well. A great example is Simon's Properties who runs advertisements to get people to shop at their malls.

Now, a great way to bring down the price of your lease is to enter into what is called a "percentage lease." This type of lease has a base amount (normally lower than a typical lease), but the price increases when the business is doing well.

Here is an example.

Let's say your normal lease would be \$5K per month at the location you want to do business. Under a business lease, let's assume you negotiate it to \$3K per month on a percentage lease, with two percent of gross sales above \$300K going to the landlord.

If you fail to reach your \$300K goal, then the rate stays the same. If you end up making \$400K, then your lease payment would increase to \$5K (two percent of the extra \$100K is \$2K added to the \$3K base = \$5K).

If you happen to make \$500K that month, then your lease would increase to \$7K for that month. However, the increase in rent can be justified as you did more in sales and in turn are able to afford the extra.

The obvious benefits to this type of lease are that you aren't hammered with a high lease rate in months when your business is in a downturn. However, there are privacy concerns as you will be required to disclose gross monthly income in order to calculate the lease rate.

When entering into a percentage-based lease, you need to know the math. The landlord does, so you need to be sure you are not taken advantage of.

"Landlords who offer this as an option are often savvy with how the numbers work and can take advantage of a relatively [new] business owner," says Andrew Longcore, Partner at The Business Law Group. "One other aspect should be considered and that is that these agreements are typically based on sales or revenue. Meaning that even at a number as low as five percent of your business's revenue, it can have a big impact on your margins."

Speaking of Simon's Properties, keep in mind that most indoor malls offer (and many require) a percentage-based lease. They understand that sales are better in some months and not in others. This type of lease may not lower the overall lease cost, but it will help decrease any burden on you in slower months.

Finding the Faults

Finding faults in the property is not only in your best interest when it comes to negotiating the lease, but it will also benefit you down the road with potential issues to your business. You really need to know if any problems with the property are going to fall into your lap once you have the doors open.

For example, prior water damage is a common commercial leasing issue. Even if restoration has taken place, it can cause you harm if not performed effectively. If you sell clothing, water damage could potentially lead to mold where you store inventory. The after-effects of water damage can be disastrous to your business.

Faults don't have to reside solely in utilities. Using other hazards outside of the property is a good way to show fault. To do this, you need to be creative. Let's say you find a location but know there will be construction on the roadway about four months into your lease. You can use this as a negotiation tool as you are likely to lose business during the months when construction is taking place. The landlord will also have difficulty filling the space during the construction process.

Let's assume that you found all the faults (water, electrical, etc.) and are still comfortable with moving into the property. Using these as a negotiating tool can help lower the cost of the lease. Do not simply throw these issues in the landlord's face as it is likely to backfire, but pointing them out in relationship to your business can be a benefit.

Here is what I mean.

Let's say you planned on remodeling the bathroom at the location. This was an expense you already planned on doing and were not going to ask for concessions from the landlord. If you can show that the bathroom has water damage and that you were going to take care of it as part of your remodeling, this is something that you should negotiate into the lease.

A landlord will be more than willing to knock money off the rent knowing that you saved them from potential long-term damage to the property.

Assuming Responsibilities

If you have entered into a business lease in the past, you already know that certain items are included in the rent. These include things such as trash removal, taxes, general maintenance (snow removal and lawn care), etc. Most commonly referred to as CAM (Common Area Maintenance), landlords factor this into the lease or charge it as an add-on to the lease.

If you can assume some of these responsibilities and the landlord is willing, then use it as a negotiating tool. A great example is snow removal. Coming from the Midwest, I can tell you that snow can be a huge problem when it comes to keeping a business open. If you operate a snow removal service, offer to keep the area clean for the landlord (and their other tenants at the same location if it applies) in exchange for a lower rate.

Now thankfully I'm in sunny Southern California, but the example still applies. Are you operating a lawn care business? Then use this to your advantage. Painter, plumber, or carpenter? Same thing applies. You should also realize that this is not the best option if you are unable to take on the additional responsibilities (or are not 100 percent sure of what you are getting into).

"Assuming CAM on its face [value] can seem like a good strategy to save money," says David Bakke from Money Crashers. "But unless you're willing and have the wherewithal and bandwidth to assume all of what that entails, it might not be the best route to go."

Make sure you are willing and able to take on the responsibility before jumping into this type of agreement.

Pre-Payment of Rent

Pre-payment of rent is something I have put last as it simply isn't practical for most businesses. While it is great in theory, I am willing to bet few (if any) people reading this article have the ability to do so. However, if you are able, this is a great way to reduce the overall cost of the lease.

As it states, you simply pre-pay the lease. You can make arrangements to pay all, or some of, the lease in advance in exchange for a lower rate. The benefit is obviously the lower rate, but is there a downside? Absolutely.

Let's assume for a minute that you enter into an agreement with a deadbeat landlord. Paying them up front takes away your leverage in the event of a breach. Many states allow you to withhold rent in certain circumstances but if you have already paid, then there is nothing you can withhold. If the landlord stops paying for trash collection, fails to pay the property tax, etc., you could be harmed as a result with a lawsuit being your only form of recourse.

On the flip side, some landlords do not accept pre-payments.

"Landlords are reluctant to accept lease pre-payment," says Alex Cohen from CORE, the leading real estate broker firm in New York City. "Generally, they prefer a security deposit that remains in place for the entire duration of the lease, though possibly with a burn-down over time if there is no default and certain thresholds are achieved."

Summing It Up

There are benefits and drawbacks to various negotiation techniques for leasing a business property. There is no cookie-cutter solution for everyone and I always advise to obtain legal advice before entering into, and even negotiating, any agreement.

However, I will say that you would be absolutely foolish to enter into a leasing agreement without considering some type of negotiating. And yes, I am speaking from experience (I was foolish and paid dearly). Lessons learned I guess.