

Smart lease renewals

Maximizing your leverage at renewal time to save money **Interviewed by Usha Viswanathan**

The best way to grow revenues is to keep customers instead of letting them flee to competitors. Usually, the approach works.

Consider the discovery by Equity Office Properties, one of the nation's largest office building landlords. It conducted an internal study to find the best way to increase revenue. Their report concluded that raising rents across their portfolio by \$0.10 per square foot would increase revenues by \$4 million. However, increasing their average occupancy by just 1 percent would increase revenues more than \$40 million. Clearly, for an office building owner, keeping those properties occupied is a very high priority.

Yet according to Craig Knox, vice president of Irving Hughes, landlords often play hardball when negotiating with existing tenants who simply want to renew their leases on favorable terms.

"It seems crazy, but at lease renewal time, landlords are offering existing tenants above-market rents with little or no concessions. They think they can get away with it because it worked in the past," Knox says.

Smart Business spoke with Knox about real estate lease renewal negotiations and how business owners can improve their lease terms while remaining in their current building.

Why does it cost a landlord so much more to find a new tenant than to renew an existing one?

When an existing tenant decides to relocate, it really opens up a Pandora's box of escalating costs and lost opportunity. Obviously, while the space sits empty, there is no rent. Considering that the average time it took to get space leased in San Diego County in 2006 was more than 15 months, that adds up to a lot of lost revenue.

When the landlord finally does find a new tenant, it is unlikely the tenant will accept the space as is, but will rather expect the landlord to build out improvements. Add to that other financial incentives tenants ask for including rent dis-



Craig Knox
Vice president
Irving Hughes

counts, free rent periods and moving allowances.

Beyond the hard dollar costs, a landlord is taking a risk with a new, unknown tenant. Should that tenant fail to perform under the new lease, you can bet the landlord will regret ever letting the former quality tenant move out over a desire to make a few extra bucks.

Then you are saying it's a windfall for the landlords when a tenant renews?

Exactly. A huge windfall. Yet they would never want their existing tenants to know that, because then the tenants will naturally expect a share of the savings.

How does the lease renewal process usually work?

Unfortunately, companies often just exercise renewal options contained in their original lease, which provide a right to stay in the space at some form of 'market' rent. These options are rarely the best choice because they force the tenant to commit to an extended term before they know what the space is going to cost. Worse is that exercising the option absolutely negates

any leverage the tenant may have in negotiating a favorable lease extension.

Even if the landlord offers to discount the rate, the tenant should not be lured into the landlord's process. The savvy tenant will drive the lease renewal process with the same focus and attention as in the original lease negotiations commanded.

What is the right lease renewal process for a tenant to follow?

We follow a very similar process whether our client believes a renewal or relocation is the most likely outcome. Our process is deliberate and designed to provide our client leverage in all possible scenarios.

In general, we evaluate the tenant's existing space utilization, identify areas for improvement, and then develop viable scenarios that save money, improve the workplace environment, or both. With alternatives in play, we can begin a dialogue with the existing landlord about the terms under which our client would consider an extended lease. It's more than just a negotiation about rent. We save money by getting a new base year, negotiating allowances to remodel the space, obtain enhanced signage and parking rights, structure expansion rights and other concessions that the tenant won't think of.

Can a tenant accomplish the same on his own without a broker?

The best renewal negotiation occurs when the landlord thinks that the tenant has one foot out the door. The landlord's leverage when we tell him that our tenant is looking at moving and might renew is completely different than when the tenant tells the landlord he has decided to renew.

By not hiring a tenant-rep broker, the tenant is sending a clear signal that relocation is definitely not a consideration — and that dramatically reduces negotiating leverage.

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