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7.16.2024 – Negotiating / Deal Making from the Landlord’s Perspective, Part 2

Welcome

Does anyone have anything great to share personally or professionally?

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Podcast

Tune in wherever you get your podcasts!

- Last Week: 15 Ways to Increase the Value of a Commercial Real Estate Property

- This Week: Creative Ways to Structure Deals to Make Them More Financially Attractive for a Tenant Up Front

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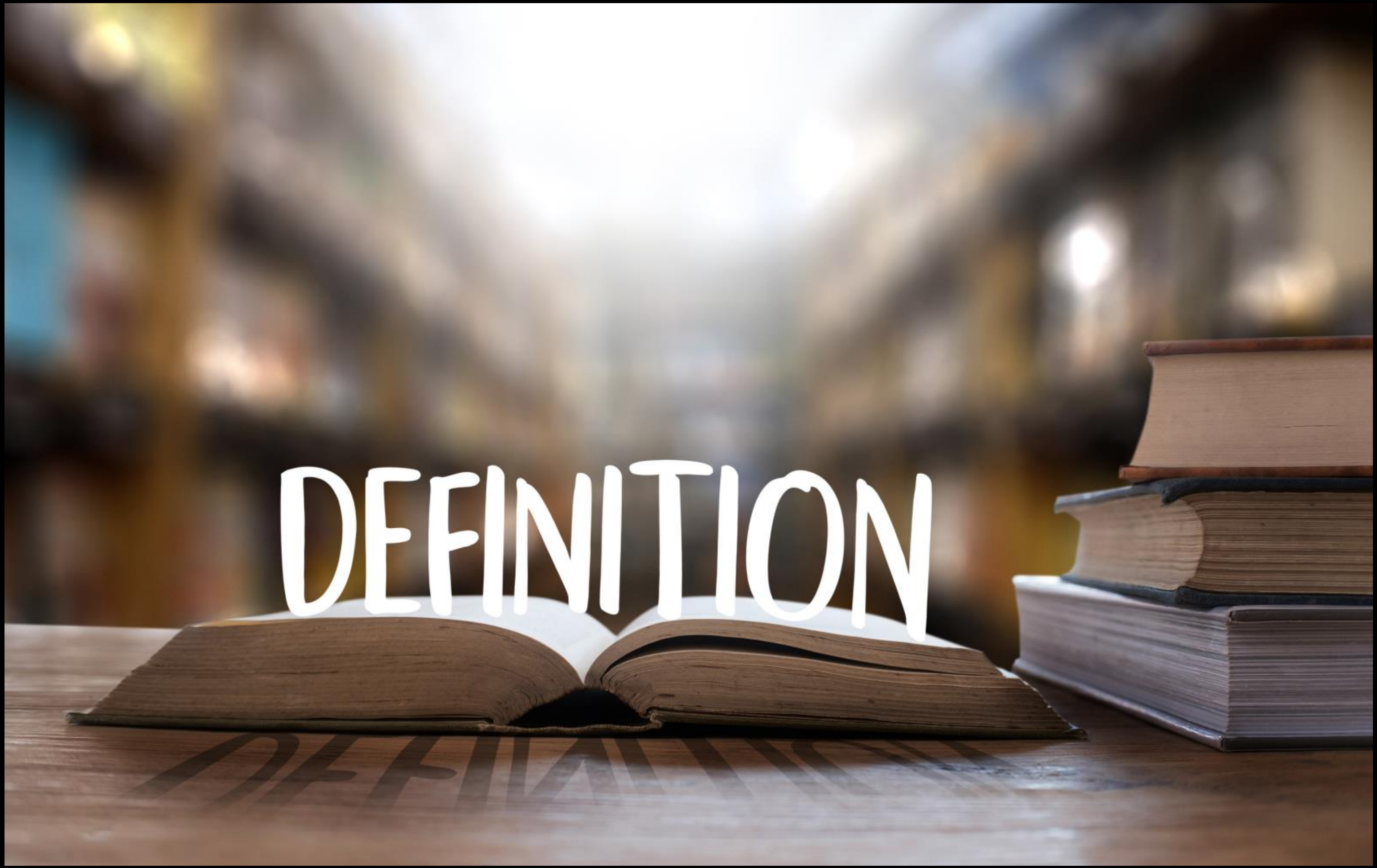
Leasing Terms



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Base Rent

The base rent is the starting point for all rents paid for the property, the minimum amount due the landlord.

The type of lease ultimately determines what is paid.

Escalations are based off the annual base rent and are only one component of the overall cost of leasing a space.

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Net Leases

- Single
- Double
- Triple

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Single Net Lease (N)

A single net lease is a rental agreement in which the tenant agrees to cover the cost of one of the three primary property expenses: taxes, insurance, or CAM (Common Area Maintenance) costs.

Double Net Lease (NN)

A double net lease is a rental agreement in which the tenant agrees to cover the cost of two of the three primary expenses: taxes, insurance or CAM (Common Area Maintenance) costs.

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Triple Net Lease (NNN)

A triple net lease is a rental agreement in which the tenant agrees to cover the cost all three primary expenses: taxes, insurance and CAM (Common Area Maintenance) costs.

Operating Expenses

Costs the owner pays to operate and maintain a building. These expenses include property taxes, insurance, utilities, maintenance, repairs, management, legal and accounting services.

It does not include mortgage payments (debt service), cost recovery or capital expenditures.

Operating expenses recur annually.

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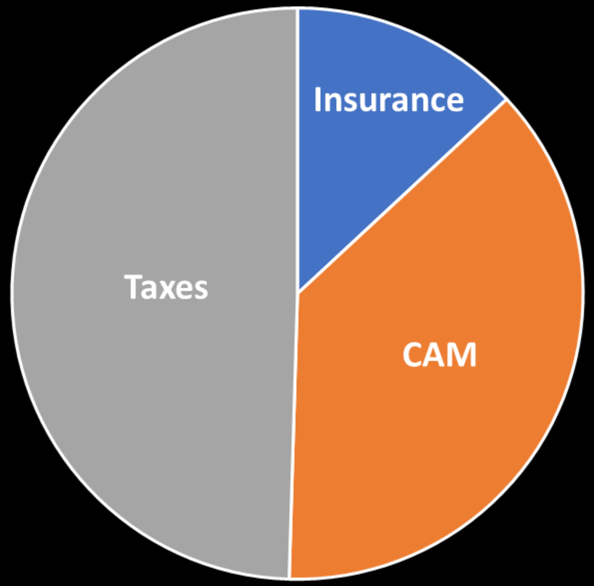
Common Charges - TIM

T = Taxes

I = Insurance

M = Maintenance (Also known as Common Area Maintenance or CAM)

Common charges generally range from $2.50 - $15.00 per SDF, depending on type of building, amount of common area and landlord philosophy.



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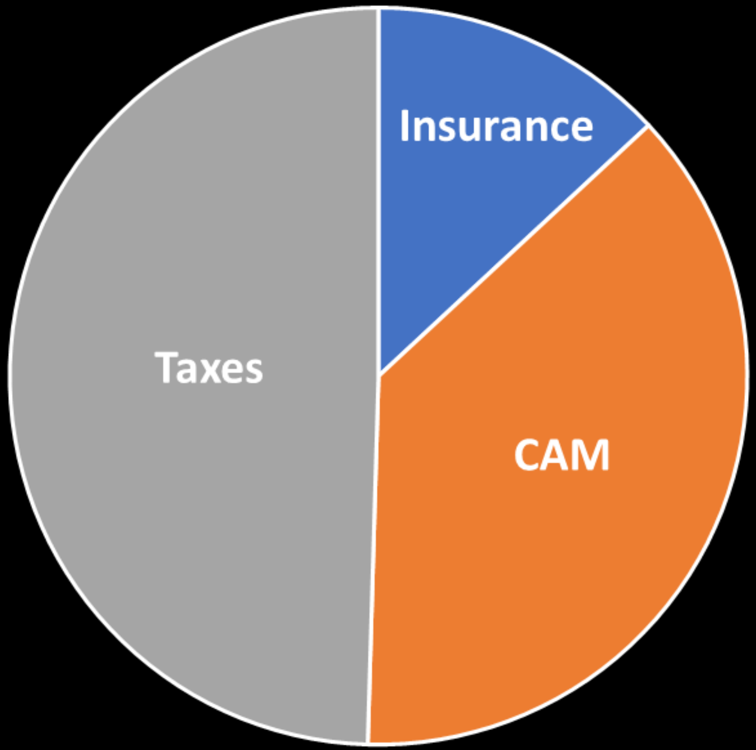
Gross Lease

There are two common gross lease types: full service and modified. In a gross lease, most or all of the expenses associated with the property are included in the rent. In some states, the landlord is required to disclose the specific costs associated with the property.



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Audience Question (Cont.)

Option A - $16/sf + $9NNN / sf

$16/sf + $9/sf NNN = $25/sf

$25/sf x 3,300 sf = $82,500 Annual

$82,500 ÷ 12 = $6,875 Monthly

Option B - $22/sf gross

$22/sf x 3,300 sf = $72,600 Annual

$72,600 ÷ 12 = $6,050 Monthly

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Total Rent

Base Rent

\+ Common Charges

\+ Utilities (Electric, Phone, Gas and Water)

= Total Rent

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Deal Making with a Landlord

Some creative ways you can structure deals to make it more attractive financially for a tenant initially:

1. Rent Abatement Period

Offer a certain period of rent abatement at the beginning of the lease term to help the tenant establish their business.

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Deal Making with a Landlord

2. Tenant Improvement Allowance

Provide funds for the tenant to customize the space to fit their needs without incurring additional costs.

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3. Step-Up Rent

Gradually increase the rent over time to give the tenant some breathing room in the early stages of the lease.

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4. Percentage Rent

Link a portion of the rent to the tenant's revenue, providing a lower base rent with additional payments based on performance.

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5. Flexible Lease Terms

Offer flexible lease terms such as shorter lease durations or options for expansion to accommodate the tenant's changing needs.

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6. Shared Resources

Provide access to shared amenities or services within the building at a reduced cost or included in the lease agreement.

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7. Net Lease Structure

Structure the lease as a net lease where the tenant pays a lower base rent but covers additional expenses like maintenance, property taxes, and insurance.

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8. Built-In Options

Include options for lease renewal at a discounted rate or for purchasing the property in the future at a pre-negotiated price.

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Deal Making with a Landlord

Which option provides more lease income for the landlord?

Let's calculate the total rent paid for years 1 through 5 in the scenario where the rent is $3000 per month and increases by 2% starting from year 2 to year 5:

- Year 1: $3000
- Year 2: $3060
- Year 3: $3121.20
- Year 4: $3183.62
- Year 5: $3247.30

Total Rent Paid for Years 1 through 5 in the last scenario:
$3000 + $3060 + $3121.20 + $3183.62 + $3247.30 = $15612.12

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Let's calculate the rent payments for each year over a span of 5 years for the new scenario where the rent is $3000 in years 1 and 2, then increases by 3% in years 3-5:

- Year 1: $3000
- Year 2: $3000
- Year 3: $3000 + (3% of $3000) = $3000 + $90 = $3090
- Year 4: $3090 + (3% of $3090) = $3090 + $92.70 = $3182.70
- Year 5: $3182.70 + (3% of $3182.70) = $3182.70 + $95.48 = $3278.18

Total Rent Paid for Years 1 through 5:
- Year 1: $3000
- Year 2: $3000
- Year 3: $3090
- Year 4: $3182.70
- Year 5: $3278.18

Total Rent Paid for Years 1 through 5:
$3000 + $3000 + $3090 + $3182.70 + $3278.18 = $15550.88

Option A: $15612.12 | Option B: $15550.88

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Deal Making with a Landlord

How can you handle the tenant fit-up allowance to make it more affordable initially for the tenant.

1. Phased Payments

Break up the fit-up allowance into multiple payments over time rather than providing a lump sum upfront.

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2. Vendor Relationships

Negotiate deals with preferred vendors or contractors to provide fit-up services at reduced rates for tenants.

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3. Shared Costs

Consider sharing the costs of fit-up with the landlord or incorporating the fit-up costs into the rental rate over the term of the lease.

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4. Allowance Credits

Instead of providing a cash fit-up allowance, offer credits for improvements or rent reductions based on agreed-upon upgrades made by the tenant.

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Deal Making with a Landlord

5. Flexible Allowance Options

Provide flexible fit-up allowance options where the tenant can choose between different fit-up packages or customize their fit-up based on their budget.

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6. Landlord Pre-Improvements

The landlord can complete certain base building improvements before the tenant takes occupancy, reducing the fit-up costs for the tenant.

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7. Reuse of Existing Fixtures

Encourage tenants to reuse existing fixtures, furniture, or equipment to lower fit-up costs.

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8. Discounted Rent Period

Offer a temporary discount on rent to offset fit-up costs incurred by the tenant during the initial months of the lease.

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An example of how a landlord can finance some of the tenant's fit-up costs by increasing the base rent and amortizing that cost over a period of time:

Let's say the tenant needs $50,000 for fit-up costs. The landlord agrees to provide $25,000 of the fit-up allowance through increased base rent and amortize it over a 5-year term.

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- The landlord increases the base rent by $5,000 per year for 5 years to cover the $25,000 fit-up allowance.

- The tenant pays an additional $5,000 in rent each year for the 5-year period.

- After 5 years, the tenant has paid off the $25,000 fit-up allowance through increased rent payments.

This way, the tenant can spread out the cost of fit-up over time, making it more manageable while still allowing the landlord to recoup the expenses.

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https://www.facebook.com/groups/commercialrealestateforresidentialrealtors

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Next Session

Negotiating/Deal Making Part 4

Tuesday, July 23, 2024 @ Noon Eastern

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