



Good Deals in Leasing **Factors the Landlords Consider When Setting the Terms of a Lease**

By Mark Keyzers - *NAI Alliance Commercial Real Estate, Reno*

As a retail commercial real estate broker I often get calls from potential tenants interested in leasing space who ask me before anything else, "What's the best deal I can get?"

My response is always the same: "It depends!"

They say, "Depends on what?" So begins a long discussion on what is relevant to both tenant and landlord to answer this question. The factors that contribute to the ability to get the best deal vary between retail, office, and industrial properties; however, generally we can consolidate them into the following categories: experience, creditworthiness, use, term, and costs.

Experience and brand recognition are obvious factors for a landlord to make concessions. When Wal-Mart leases space an owner knows that they are bringing fame and track record. So what can someone do who does not have experience? A franchise system is a good start since they have a regimented process that provides recognition. What if you do not want to be a franchise? The answer is a business plan. The most important thing you can do is illustrate experience, research, analysis, and preparation for the business. The more you demonstrate you know all the facets to conduct the business with your experience, the better ownership understands you know what you're doing and it mitigates their risk to relax terms.

Creditworthiness is a major factor to access risk and return value on a tenant. Creditworthiness is the combination of net worth, liquidity and payment history that determines a tenant's financial lender at the best interest rate.

As with brand recognition, an owner will be desirous to first have a "national credit" tenant that most lenders deem to be investment grade providing for the project's success. When owners perform credit checks, they are especially careful to determine if the entity named on the lease has substantial net worth and liquid assets or they will look to the individual(s) to provide a personal guarantee with the same. It's critical when financing or selling the property that ownership can lock in on a lower rate, and also lower the capitalization rate (the return on the income), which reflects a higher selling price. Tenants with proven credit have a direct impact on the rating of the development; the higher the rating, the lower the cap rate and the better the investment. In the end, the old saying is, "The more money you have, the better the deal."

Type of use is critical to a development's strategy to have businesses that create synergy that complement and enhance each other. A landlord must weigh the risk of the tenant against the tenant's perceived importance to the particular development's merchandising and tenanting plan. So the question is how critical is the tenant to drawing more synergy to the project? A landlord may relax its credit standard if the tenant is complementary and beneficial to the overall project. For example a

smoothie shop will be more beneficial to a retail building with other food service than an automotive supply store. If a landlord knows that a certain type of use will benefit the project, he is more willing to provide better terms.

Length of lease term is often overlooked by a tenant in negotiating a better rate. A typical lease term for commercial space is five years. Many times tenants ask me if they can do a shorter term on the lease. I tell them it is possible, but the landlord will want more rent. This is often a surprise to a tenant, especially if a space has been vacant for sometime. The answer lies in the fact that the landlord now has more financial insecurity and risk in its cash flow over time. The landlord's concern is that there is more risk in having the space back sooner due to a perceived lack of commitment and confidence by the tenant in its business combined with the potential of "missing out" on another tenant that will commit to a longer term. Oftentimes a tenant thinks that if a space has been vacant for a while that the owner will lower the rate and term. This can be the case with an underperforming property. However with a well-positioned property the landlord is much more concerned about the impacts to finance and sell the asset. As such, the longer the lease term, the more security provided in the longevity of the cash flow and the better the deal.

Costs are fundamental in effecting lease terms. The more it costs to place a tenant translates directly to return on investment. Tenants must demonstrate the funding necessary to build out quality space improvements and that potential cost overruns will not put them out of business. If tenants need ownership to spend more money or provide more time for construction to provide more space, owners must "build" those costs back into the rent with interest to achieve the desired return, which is typically higher than what is available from a lender. Therefore, if a tenant can reduce the amount of costs to the landlord for providing them the space the more a landlord can be flexible on the rent.

So, how do you get the best deal on a lease? It depends on your experience and the preparation of a thorough business plan illustrating all facets of opening and operating your business and demonstrating adequate funding and cost measures to make your business happen.

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