



What Every Small Business
Owner Should Know Before

Leasing Commercial Space



There is much more riding on your commercial lease than getting a good deal on rent.

Leasing commercial space is probably one of the most important decisions you'll make as a business owner. Choosing the right property on the right terms may be just as critical to your success as establishing a sound business model. Sure, getting a good deal on rent today is vital, but a well-crafted lease will ultimately protect your interests for the long haul.

With so much riding on commercial lease agreements, these documents can be especially complex. Why? Primarily because they establish a necessary relationship between landlord and tenant, covering a wide variety of terms and contingencies that have lasting financial implications for both parties.

So it's not surprising this process is ripe for missteps if you don't do your homework. No matter what size company you operate, it's essential you get off to a good start. Engaging an experienced commercial real estate broker may save you time, money and headache, and can be critical to your bottom line for years to come.

Whether you've a first time tenant or you've been around the block before and need a refresher, to help you better navigate the sometimes arduous leasing process we've outlined some of the most important items a small business owner (really, every business owner) should understand before entering into a lease agreement.

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The Lease Proposal

Before you even get to the lease signing stage, your efforts to lease commercial space may typically start with a lease proposal. This is generally a non-binding agreement between a tenant and landlord that allows for some wiggle room prior to reaching an actual lease agreement, which would be more permanent. At this early stage, you will likely have all your financial statements ready, which may also include your business plan, to submit to the landlord for their consideration.

The purpose of a lease proposal is really two-fold. It serves to help the landlord understand your viability as a potential tenant. More importantly, your financial statements will help you define just how much you can invest in leasing a space for your business. An experienced leasing broker will assist you in preparing or organizing the needed materials, and they can also help you assess your financials to understand if the potential lease is right for your business.

The Lease Agreement

Understanding some basic but important terminology, in addition to the core elements involved in a commercial lease, will go a long way in getting you to the finish line. As we mentioned, lease agreements can be confusing, so we've put together a list of some of the most common terms and considerations.

The 3 Most Common Types of Lease Structures

The lease rent structure is often the component of a lease that causes the most confusion for tenants. There are three main types of lease structures, which we outline briefly below. However it's important to remember that there can often be variations on these structures, and your agent can help give you a clear understanding of the lease that's on the table.

Triple Net Lease (NNN): In this form of lease structure, in addition to the base rent and utilities, the tenant is responsible for paying its share of all operating expenses associated with a property, including real estate taxes, property insurance and common area maintenance (CAM) costs.

Gross Lease: In this case the tenant pays a set sum for rent, and the landlord pays the real estate expenses including taxes, insurance and CAM costs.

Modified Gross Lease: This type of lease is essentially a hybrid of a net and gross lease. The foundation is generally a gross lease, but the tenant will be responsible for certain increases in the operating expenses over the lease term.



Pros and Cons of Different Leasing Structures

Tenants typically prefer a Gross Lease, because the landlord cannot pass along the NNN expenses. On a Gross Lease, landlords will factor such expenses into the rent, so technically the tenant is still paying a portion of their rent to cover those expenses. That said, the tenant is usually shielded from any unexpected increases in the NNN's, especially when a property is sold and the property taxes increase substantially, for example.

Somewhere in between is a Modified Gross lease, where the landlord passes along increases in NNN expenses only above an initial budget for those NNN expenses. The Modified Gross Lease is typically more attractive to a tenant than a NNN lease, but not as ideal as a Gross Lease. You should consult with your agent to determine the true costs of your lease in any of these lease structures.

Long Term Versus Short Term Leases

Long Term Leases: While landlords tend to want long term leases, which create more stability for their portfolio and guarantee vacancy rates for a longer period of time, it may not be the best for your business. It all depends on the stability of your business and your potential for growth.

There can be distinct advantages for tenants to secure a five- or ten-year lease, as you will have your budget set for this investment over a longer period of time. However, if you find yourself in the situation where you need to move to a larger location due to growth, or worse, you have to close up shop, being locked into a longer lease could create serious financial challenges for you. Depending on the terms of your agreement, subleasing your space to another business may or may not be an option. Ultimately you may find yourself on the hook for rent that extends beyond the time you physically occupy your space.

Short Term Leases: This provides the most amount of room for growth and allows your business to be nimble with the possibility of moving after a year or two depending on the set amount of time for the contract.

However, when your initial lease term expires, you must be prepared for a variety of scenarios, and they may all come with higher rent and potential budget instability if you don't plan properly. For example, your landlord may allow you to keep your space on a costly month-to-month basis, or you may have to negotiate a lease renewal with less favorable terms, or you may have to move if the landlord finds another tenant to pay a higher lease rate.

The point is, nothing substitutes a good long term plan and your experienced commercial real estate agent can help you understand the ramifications of leasing on a short or long term, and will likely be in the best position to negotiate your options.





Renewing, Expanding or Terminating Your Lease

As important as it is to establish the right lease terms, as we previously alluded to it's equally important to factor in the "what-if's" as best you can. What happens if your business out-grows your current location and you need to expand your space? What happens if the alternate is the case and you need to downsize or even terminate your lease? What if you simply want to renew your lease at the term's conclusion?

You should have a clear understanding of the landlord's requirements (or flexibility) in any of these scenarios, and having the details written into your agreement is advisable. For example, if you must terminate your lease prior to your lease expiration, what are the provisions? Does the landlord allow the leased property to be assigned or subleased? If so, what are the specific responsibilities associated with such a change?

Your agent will help you negotiate any penalties for the possibility of terminating a lease early, prior to finalizing and signing the lease agreement.

Making Changes to the Property with Tenant Improvements (TI)


Beyond slapping on a fresh coat of paint, commercial spaces often require more involved remodeling in order to suit them to the specific needs of your business. Negotiating Tenant Improvements (TIs) can be an integral part of your lease agreement, but you must do your homework before signing your lease and implementing TIs. This includes carefully considering what specific changes will be made to the property, determining the hard costs of such improvements, clarifying who will pay for them, who will own them upon completion, and whether the property must be returned to its original state before ending the lease and vacating the premises.

Therefore it's imperative you have a clear understanding of the cost to construct your tenant improvements and the time it will take to complete them, before you sign the lease.



Other specifics to consider before signing a lease

While it's nearly impossible to foresee every potential issue that could surface and impact your lease, you owe it to yourself to cover as much turf up front. Chances are your agent has seen enough in their career to know what other questions to ask or possible situations that could arise. For example, what happens if the property sells during your lease term? The type of lease you have will have a big impact on how the transition will be managed.




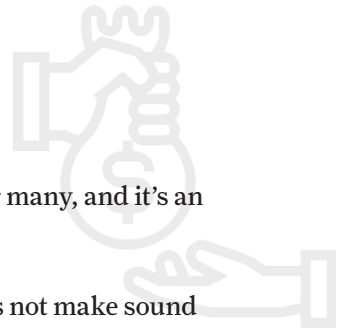
What are the impacts of parking, signage and location on your business? There may not be much flexibility with these items in terms of what the landlord can offer, but you still need to do your diligence. For example, is on-site parking limited or reserved, will your clients or customers have to park on the street and is that a problem?

Who are your neighbors? Tenant mix is important for any commercial real estate property, and it can have a direct impact on your business. If your business relies on foot traffic that is drawn by your neighboring businesses, ask about a co-tenancy clause that will provide some protection to your business in the event neighboring spaces are not leased within a specific amount of time after a vacancy opens.

Additionally, if you would rather not compete with other similar businesses, you can look into adding an exclusive use clause for your lease in order to protect your interests within the commercial property.

And a few things to have on your post-signing list

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- Calendar the date of your annual rent increases and rent amounts
 - Reconcile the triple net expenses on an annual basis
 - Regularly compare your Estimated vs. Actual Expenses
 - Calendar the date your lease expires as well as the date you have to notify the landlord should you elect to renew or extend your lease term
 - Obtain current lease comparables from a local broker to help in your lease re-negotiations



Maybe buying is the better option?

Are you better off owning your building or leasing it? That's the \$64,000 question for many, and it's an understatement to say there is a lot that goes into answering that question.

Owning your own property can be right for many people but for others it simply does not make sound financial sense. Among the many considerations, you must determine the cost to finance a commercial property from both traditional and SBA financing sources, and weigh the pros and cons on both types of financing. If you're serious about it, you also need to do a full financial workup to compare the costs to buy the property versus leasing it. Take into consideration the tax benefits of owning a building. Buying can set your annual costs and provide additional equity with appreciation and the principal pay down of your loan.

The bottom line is...

There is a lot that goes into a commercial lease, and all of it will directly impact your company's bottom line today or tomorrow.

We have outlined some of the core terms and questions you will need to consider as a part of your lease. You owe it to yourself to be armed up front with as much information as possible, whether going it alone or hiring a commercial broker. But the reality is for most people, navigating a commercial lease or a sale can be like learning a foreign language, and nothing substitutes having an experienced advocate in your corner who is fluent and focused solely on the task at hand.

For more information or for assistance in your leasing, buying or selling efforts, [contact The Radius Team today.](#)



For More Information

To learn more about commercial brokerage solutions or to speak to a qualified representative today, please contact Radius Commercial Real Estate at:

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